John J. Pringle, Jr.
Direct dial: 803/343-1270
jpringle@ellislawhorne.com

May 6, 2004

VIA ELECTRONIC MAIL SERVICE AND HAND-DELIVERY
The Honorable Bruce Duke
Executive Director
South Carolina Public Service Commission
PO Drawer 11649
Columbia SC 29211

RE: Application of TC Systems, Inc. for a Certificate of Public Convenience and Necessity to Provide Local Exchange Service (including Exchange Access) and Intrastate Interexchange Telecommunications Services Within the State of South Carolina, for Flexible Rate Structure for Local Exchange Service Offerings First Approved in Docket No. 97-467-C and for Alternative Regulation First Approved in Docket No.
95-661-C**, Docket No. 2004-0074-C, Our File No. 611-10226**

Dear Mr. Duke:

Enclosed is the original and twenty-five (25) copies of the **Testimony of John S. Sczepanski** filed on behalf of TC Systems, Inc. in the above-referenced docket.

Please acknowledge your receipt of this document by file-stamping the copy of this letter enclosed, and returning it via the person delivering same.

If you have any questions or need additional information, please do not hesitate to contact me.

Very truly yours,

/S/

John J. Pringle, Jr.

JJP/cr
cc: Gene Coker, Esquire
Mr. John S. Sczepanski
Enclosures
G:\APPS\OFFICE\WPWIN\WPDOCS\AT&T\TCG Certification\Testimony\DukeTestimony.wpd

BEFORE THE

SOUTH CAROLINA PUBLIC SERVICE COMMISSION

IN RE: APPLICATION OF TC SYSTEMS, INC. FOR A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY TO PROVIDE LOCAL EXCHANGE SERVICE AND INTRASTATE INTEREXCHANGE TELECOMMUNICATIONS SERVICES WITHIN THE STATE OF SOUTH CAROLINA, FOR FLEXIBLE RATE STRUCTURE FOR LOCAL EXCHANGE SERVICE OFFERINGS FIRST APPROVED IN DOCKET NO. 97-467-C AND FOR ALTERNATIVE REGULATION FIRST APPROVED IN DOCKET NO. 95-661-C	)	DOCKET NO. 2004-0074-C

TESTIMONY OF

JOHN S. SCZEPANSKI

ON BEHALF OF

TC SYSTEMS, INC.

May 6, 2004

Q. What are your name, your business address and your current position?

A. My name is John S. Sczepanski. I am a Division Manager for Business Local Voice Services for AT&T Corp., located at One AT&T Way, Bedminster, New Jersey.

Q. Please describe your educational background and professional experience.

A. I have worked for AT&T or one of its affiliates for 17 years in network operations and product management positions. I am a graduate of La Salle University, Philadelphia, Pa. with a business degree. I have been a Division Manager for AT&T's Business Local Service since 1997 and have extensive experience in all functional areas of business local services, including, sales, offer, product, provisioning, care, maintenance, and systems. I am knowledgeable about AT&T's efforts to provide local service to Small and Mid size business customers.

Q. Please describe your current job responsibilities.

A. My current responsibilities include managing local service small business products including AT&T's All In One and Prime Services, throughout their life cycle consistent with the needs of the marketplace and AT&T. I am also responsible for delivering the product's operating results and improving the customer experience. I also support various legal/regulatory issues that affect our small business products.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to explain the services that TC Systems proposes to offer in the state and explain the benefits to business customers in South Carolina of certificating TC Systems to enable it to provide such services.

Q. What is TC Systems?

A. TC Systems is an indirect, wholly-owned subsidiary of AT&T Corp. A copy of TC Systems' Articles of Incorporation is attached as Exhibit "A". It is also an affiliate of AT&T Communications of the Southern States, LLC, a company already certificated to provide telecommunications services in South Carolina. Through its subsidiaries, including these two entities, AT&T Corp. provides domestic and international telecommunications services throughout the United States.

Q. What services does TC Systems propose to provide?

A. TC Systems proposes to lease transmission lines and unbundled network elements ("UNEs") – including the UNE Platform ("UNE-P") – from incumbent carriers in order to facilitate the provision of two retail services – All in One and Prime Path – by AT&T Communications of the Southern States, LLC. As the purchaser of local network elements from the incumbents, TC Systems will be positioned to provide terminating access services to those carriers that transmit calls to the customers of the retail services provided over these elements, and has filed an access tariff for this purpose.

Q. Why is TC Systems not proposing to provide the retail services in its own name?

A. As to the retail services, the ordering, provisioning and billing systems for these services are resident in the AT&T support systems, so it is most efficient for the retail services to be tariffed and offered via AT&T Communications of the Southern States, LLC. However, AT&T uses Teleport Communications Group ("TCG") support systems to order and track UNE expenses for the AT&T family of business services, including All in One and Prime Path services. TC Systems is part of the "Teleport Communications Group" of companies. These support systems and the ILEC operating support systems are "hard wired" with TCG codes that must be used in the UNE-P ordering process. Therefore, a code (an "operating carrier number" or" OCN") associated with a TCG entity must be utilized when ordering UNEs for these services. This will enable TC Systems to separately identify and track the expenses associated with the provision of these services, which will be transferred and journalized to the appropriate AT&T Communications of the Southern States, LLC expense account.

Q. How does the provision of TC Systems' proposed services benefit customers in South Carolina?

A. By facilitating the introduction of two popular small business services in South Carolina, TC Systems benefits business customers in South Carolina in two ways. First, the availability of these services – which are already available in 34 states – will enable businesses (small and large) that have locations in the state to purchase these services and thus expand the efficiency and utility of these services to these locations. Second, the services will of course be offered to business customers in South Carolina, and this will expand the competitive choices for those customers. Greater competition in the small business market in the state will spur innovation in features and price – all of which benefits South Carolina's small business customers.

Q. Does TC Systems possess the financial, managerial and technical ability to provide telecommunications services in South Carolina?

A. Yes. The people providing financial and managerial support to TC Systems are the same people that provide support to AT&T Corp., AT&T Communications of the Southern States, LLC and the other affiliates of AT&T Corp. Attached as Exhibit “B” are brief biographical sketches of the key officers of TC Systems, Inc. Copies of AT&T Corp.’s most recent Form 10 Q and its 2002 Annual Report, which include comprehensive information on AT&T Corp.’s financial status, management and services were attached to the Application for Certification. Attached as Exhibit “C” are financial statement excerpts from AT&T Corp’s 2003 Annual Report to Stockholders.

Q. Has TC Systems prepared a tariff for the services that it will be offering?

A. Yes. Our tariff group has prepared an access services tariff, which was previously filed in this proceeding.

Q. Does this conclude your testimony?

A. Yes.

State of Delaware

Office of the Secretary of State

I, EDWARD J. FREEL, SECRETARY OF STATE OF THE STATE OF DELAWARE, DO HEREBY CERTIFY THE ATTACHED IS A TRUE AND CORRECT COPY OF THE CERTIFICATE OF AMENDMENT OF "TC SYSTEMS, INC.", FILED IN THIS OFFICE ON THE FOURTH DAY OF OCTOBER, A.D. 1996, AT 12 O'CLOCK P.M.

A CERTIFIED COPY OF THIS CERTIFICATE HAS BEEN FORWARDED TO THE NEW CASTLE COUNTY RECORDER OF DEEDS FOR RECORDING.

GREAT SEAL OF THE STATE OF DELAWARE
LIBERTY AND INDEPENDENCE
1793 · 1847 · 1907

SECRETARY'S OFFICE
1793 DELAWARE 1847

Edward J. Freel, Secretary of State

2208190 8100

960289843

AUTHENTICATION: 8135555

DATE: 10-07-96

CERTIFICATE OF AMENDMENT
OF
CERTIFICATE OF INCORPORATION
OF
TC SYSTEMS, INC.

TC SYSTEMS, INC., a corporation organized and existing under the laws of the State of Delaware, **DOES HEREBY CERTIFY:**

First: That the Board of Directors of the Corporation, on October 4, 1996, acting by unanimous written consent, adopted a resolution proposing and declaring advisable an amendment to the Certificate of Incorporation of the Corporation and directing that such amendment be submitted for consideration by, and unanimous written consent of, the sole stockholder of the Corporation, at the convenience of such stockholder, in lieu of a meeting of stockholders, Article III of the Certificate of Incorporation, as proposed to be amended by such resolution, is as follows:

ARTICLE III

CORPORATE PURPOSES

The purpose of the Corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of the State of Delaware, including, without limitation, constructing, owning, using and maintaining a line or lines of electric telephone wholly within or partly without the state, or to acquire and own any interest in any such line or lines, or any grants therefor or for any or all of such purposes.

Second: That on October 4, 1996, in lieu of a meeting of stockholders, the foregoing proposed amendment was adopted by unanimous written consent of the sole stockholder of the Corporation as permitted by Section 228 of the General Corporation Law of the State of Delaware and under Article II, Section 11 of the Corporation's By-Laws.

Third: That the foregoing amendment has been duly adopted in accordance with the provisions of Section 242 of the General Corporation Law of the State of Delaware.

IN WITNESS WHEREOF, the Corporation has caused this certificate to be signed by a Senior Vice President, with its corporate seal to be hereunto duly affixed and to be attested by its Secretary this 4th day of October, 1996.

By: ______________________
Senior Vice President

Attest:

____
John W. Thomson
Secretary

BOOK 918 PAGE 244

State of Delaware

PAGE 1

25698

DOCUMENTARY
SURCHARGE
PAID $3.00

Office of Secretary of State

I, MICHAEL HARKINS, SECRETARY OF STATE OF THE STATE OF DELAWARE DO HEREBY CERTIFY THE ATTACHED IS A TRUE AND CORRECT COPY OF THE CERTIFICATE OF INCORPORATION OF TC SYSTEMS, INC. FILED IN THIS OFFICE ON THE TWENTIETH DAY OF SEPTEMBER, A.D. 1989, AT 10 O'CLOCK A.M.

! ! ! ! ! ! ! ! ! !

DEPARTMENT OF STATE
OFFICE OF THE SECRETARY OF STATE
1835 1793 1970
DELAWARE

729263003

Michael Harkins, Secretary of State

AUTHENTICATION: 12344444

DATE: 09/20/1989

729263003

CERTIFICATE OF INCORPORATION

of

TC SYSTEMS, INC.

FILED

SEP 20 1989 10Am

ARTICLE I

Name

The name of the Corporation is TC Systems, Inc.

ARTICLE II

Registered Office and Registered Agent

The registered office of the Corporation in the State of Delaware is located at Corporation Trust Center, 1209 Orange Street, in the City of Wilmington, County of New Castle. The name of the Corporation's registered agent is The Corporation Trust Company.

ARTICLE III

Corporate Purposes

The purpose of the Corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of the State of Delaware.

ARTICLE IV

Authorized Shares

Section 1. Shares Authorized. The total number of shares of all classes of capital stock that the Corporation is authorized to issue is two thousand (2,000) shares, of which one thousand (1,000) shares shall be Common Stock, par value ten dollars ($10.00) per share ("Common Stock") and one thousand (1,000) shares shall be Preferred Stock, par value ten dollars ($10.00) per share ("Preferred Stock").

Section 2. Rights and Restrictions of Preferred Stock. Authority is hereby expressly vested in the Board of Directors of the Corporation, subject to the provisions of this Article IV and to the limitations prescribed by law, to authorize the issue from time to time of one or more series of Preferred Stock and with respect to each such series to fix by resolution or resolutions the voting powers, full or limited, if any, of the shares of such series and the designations, preferences and relative, participating, optional or other special rights and the qualifications, limitations or restrictions thereof. The authority of the Board of Directors with respect to each series shall include, but not be limited to, the determination or fixing of the following:

(a) The designation of such series.

(b) The dividend rate of such series, the conditions and dates upon which such dividends shall be payable, the relation which such dividends shall bear to the dividends payable on any other class or classes or series of the Corporation's capital stock, and whether such dividends shall be cumulative or non-cumulative.

(c) Whether the shares of such series shall be subject to redemption for cash, property or rights, including securities of any other corporation, by the Corporation at the option of either the Corporation or the holder or both or upon the happening of a specified event, and, if made subject to any such redemption, the times or events, prices and other terms and conditions of such redemption.

(d) The terms and amount of any sinking fund provided for the purchase or redemption of the shares of such series.

(e) Whether or not the shares of such series shall be convertible into, or exchangeable for, at the option of either the holder or the Corporation or upon the happening of a specified event, shares of any other class or classes or of any other series of the same or any other class or classes of the Corporation's capital stock and, if provision be made for conversion or exchange, the times or events, prices, rates, adjustments, and other terms and conditions of such conversions or exchanges.

(f) The restrictions, if any, on the issue or reissue of any additional Preferred Stock.

(g) The rights of the holders of the shares of such series upon the voluntary or involuntary liquidation, dissolution or winding up of the Corporation.

(h) The provisions as to voting, options and/or other special rights and preferences, if any.

Section 3. <u>Rights and Restrictions of Common Stock</u>. The powers, preferences, rights, qualifications, limitations or restrictions thereof in respect to the Common Stock are as follows:

(a) The Common Stock is junior to the Preferred Stock and is subject to all powers, rights, privileges, preferences and priorities of the Preferred Stock as herein or in any resolution or resolutions adopted by the Board of Directors pursuant to authority expressly vested in it by the provisions of Section 2 of this Article.

(b) The Common Stock shall have voting rights for the election of directors and for all other purposes, each holder of Common Stock being entitled to one vote for each share thereof held by such holder, except as otherwise required by law.

Section 4. Increase or Decrease in Amount of Authorized Shares. The number of authorized shares of any class or classes of capital stock of the Corporation may be increased or decreased by an amendment to this Certificate of Incorporation authorized by the affirmative vote of the holders of a majority of the shares of the Common Stock outstanding and entitled to vote thereon and, except as expressly provided in the Certificate of Incorporation or in any resolution or resolutions adopted by the Board of Directors pursuant to the authority expressly vested in it by the provisions of Section 2 of this Article with respect to the Preferred Stock and except as otherwise provided by law, no vote by holders of capital stock of the Corporation other than the Common Stock shall be required to approve such action.

Section 5. Shares Entitled to More or Less than One Vote. If, on any matter, any class or series of the Corporation's capital stock shall be entitled to more or less than one vote for any share, every reference in this Certificate of Incorporation and in any relevant provision of law to a majority or other proportion of stock shall refer to such majority or other proportion of the votes of such stock.

ARTICLE V

Corporate Existence

The Corporation is to have perpetual existence.

ARTICLE VI

Powers of Board of Directors

In furtherance and not in limitation of the powers conferred by statute, the Board of Directors of the Corporation is expressly authorized:

(a) To make, alter, amend or repeal the By-Laws, except as otherwise expressly provided in any By-Law made by the holders of the capital stock of the Corporation entitled to vote thereon. Any By-Law may be altered, amended or repealed by the holders of the capital stock of the Corporation entitled to vote thereon at any annual meeting or at any special meeting called for that purpose.

(b) To authorize and cause to be executed mortgages and liens upon the real and personal property of the Corporation.

(c) To determine the use and disposition of any surplus and net profits of the Corporation, including the determination of the amount of working capital required, to set apart out of any of the funds of the Corporation, whether or not available for dividends, a reserve or reserves for any proper purpose and to abolish any such reserve in the manner in which it was created.

(d) To designate, by resolution passed by a majority of the whole Board of Directors, one or more committees, each committee to consist of two or more directors of the Corporation, which, to the extent provided in the resolution designating the committee or in the By-Laws of the Corporation, shall, subject to the limitations prescribed by law, have and may exercise all the powers and authority of the Board of Directors in the management of the business and affairs of the Corporation and may authorize the seal of the Corporation to be affixed to all papers that may require it. Such committee or committees shall have such name or names as may be provided in the By-Laws of the Corporation or as may be determined from time to time by resolution adopted by the Board of Directors.

(e) To adopt such pension, retirement, deferred compensation or other employee benefit plans or provisions as may, from time to time, be approved by it, providing for pensions, retirement income, deferred compensation or other benefits for officers or employees of the Corporation and of any corporation that is a subsidiary of the Corporation, or any of them, in consideration for or in recognition of the services rendered by such officers or employees or as an inducement to future efforts. No such plan or provision, which is not at the time of adoption unreasonable or unfair, shall be invalidated or in any way affected because any director shall be a beneficiary thereunder or shall vote for any plan or provision under which he may benefit.

(f) To exercise, in addition to the powers and authorities hereinbefore or by law conferred upon it, any such powers and authorities and do all such acts and things as may be exercised or done by the Corporation, subject, nevertheless, to the provisions of the laws of the State of Delaware and of the Certificate of Incorporation and of the By-Laws of the Corporation.

ARTICLE VII

Limitation of Directors' Liability; Indemnification by Corporation

Section 1. Limitation of Directors' Liability. (a) No director of the Corporation shall be personally liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except, to the extent provided by applicable law, for liability (i) for breach of the director's duty of loyalty to the Corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) pursuant to Section 174 of the Delaware General Corporation Law or (iv) for any transaction from which the director derived an improper personal benefit. If the Delaware General Corporation Law is hereafter amended to authorize corporate action further limiting or eliminating the personal liability of directors, then the liability of each director of the Corporation shall be limited or eliminated to the full extent permitted by the Delaware General Corporation Law as so amended from time to time.

(b) Neither the amendment nor repeal of this Section 1, nor the adoption of any provision of the Certificate of Incorporation inconsistent with this Section 1, shall eliminate or reduce the effect of this Section 1, in respect of any matter occurring, or any cause of action, suit or claim that, but for this Section 1, would accrue or arise, prior to such amendment, repeal or adoption of an inconsistent provision.

Section 2. Indemnification by Corporation. (a) The Corporation shall indemnify any person who is or was a director or officer of the Corporation, with respect to actions taken or omitted by such person in any capacity in which such person serves the Corporation, to the full extent authorized or permitted by law, as now or hereafter in effect, and such right to indemnification shall continue as to a person who has ceased to be a director or officer, as the case may be, and shall inure to the benefit of such person's heirs, executors and personal and legal representatives; provided, however, that, except for proceedings to enforce rights to indemnification, the Corporation shall not be obligated to indemnify any person in connection with a proceeding (or part thereof) initiated by such person unless such proceeding (or part thereof) was authorized in advance, or unanimously consented to, by the Board of Directors of the Corporation.

(b) Directors and officers of the Corporation shall have the right to be paid by the Corporation expenses incurred in defending or otherwise participating in any proceeding in advance of its final disposition.

(c) The Corporation may, to the extent authorized from time to time by the Board of Directors, provide rights to indemnification and to the advancement of expenses to employees and agents of the Corporation.

(d) The rights to indemnification and to the advancement of expenses conferred in this Section 2 shall not be exclusive of any other right that any person may have or hereafter acquire under this Certificate of Incorporation, the by-laws, any statute, agreement, vote of stockholders or disinterested directors, or otherwise.

(e) Any repeal or modification of this Section 2 by the stockholders of the Corporation shall not adversely affect any rights to indemnification and to advancement of expenses that any person may have at the time of such repeal or modification with respect to any acts or omissions occurring prior to such repeal or modification.

ARTICLE VIII

Reservation of Right to Amend Certificate of Incorporation

The Corporation reserves the right to amend, alter, change or repeal any provisions contained in this Certificate of Incorporation in the manner now or hereafter prescribed by law, and all the provisions of this Certificate of Incorporation and all rights and powers conferred in this Certificate of Incorporation on stockholders, directors and officers are subject to this reserved power.

ARTICLE IX

The name and mailing address of the incorporator is Gary C. Dolan, World Financial Center, North Tower, New York, New York 10281-1222.

For the purpose of forming a corporation pursuant to the General Corporation Law of the State of Delaware, the undersigned hereby declares and certifies that the facts herein stated are true; and accordingly has hereunto set his hand this 18th day of September, 1989.

Gary C. Dolan
Incorporator

RECEIVED FOR RECORD

SEP 21 1989

EVELYN T. ALEMAR, Recorder

8981C

BIOGRAPHICAL SKETCH OF KEY OFFICERS

President Fredrick K. Wallach
One AT&T Way
Bedminster, New Jersey 07921

Frederick K. Wallach serves as Senior Attorney for AT&T Corp. and has been employed by AT&T since 1973. He received his BS Degree from Cornell University in 1959 and his LLB from Harvard Law School in 1962.

Treasurer E. M. Dwyer
One AT&T Way
Bedminster, New Jersey 07921

Ed Dwyer is Vice President and Treasurer of AT&T responsible for managing the financial assets of the business including supporting AT&T's capital requirements and financing activities. He is responsible for all traditional treasury and risk management activities, including cash management, financing, insurance, and managing the Company's relationships with banks and credit rating agencies. In addition, Ed oversees the management of $35 billion of employee benefit assets and its Investor Relations efforts.

In his prior assignment, Ed was Senior Vice President and Chief Financial Officer of AT&T Capital Corporation, a $12 billion publicly-owned equipment leasing and finance company with operations in 22 different countries. In this capacity, his responsibilities included not only the traditional finance areas of Accounting, Treasury, Investor Relations, Taxes, and Business Planning, but also extended to Credit and Asset Management.

Before joining AT&T Capital, Ed spent six years at AT&T with assignments covering all dimensions of Treasury management, domestic and international. Additionally, Ed is a Certified Public Accountant; he worked several years with PricewaterhouseCoopers prior to joining AT&T.

Ed is a summa cum laude graduate of Temple University with a degree in Accounting, and he graduated with Distinction from the Wharton School with an MBA in Finance.

Vice-President and General Counsel	Thomas G. Dagger One AT&T Way Bedminster, New Jersey 07921

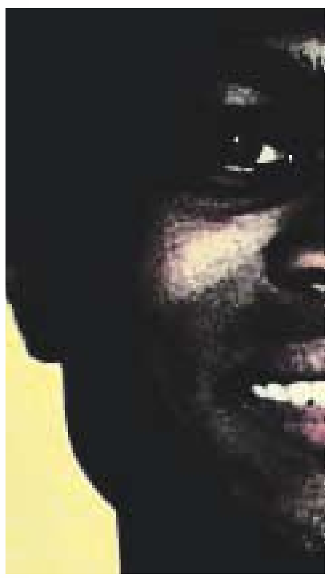
Thomas G. Dagger serves as Network Access and Local Service Law Vice President for AT&T Corp. and has been employed by AT&T since 1992. Prior to that time, Tom was an associate at Cleary, Gottlieb, Steen & Hamilton from 1986 – 1992. He received his A.B. Degree from Duke University in 1979 and his J.D. from the University of Chicago Law School in 1985.

Secretary	Robert S. Feit One AT&T Way Bedminster, New Jersey 07921

Robert S. Feit is currently Vice President-Law and Corporate Secretary of AT&T Corp. Mr. Feit has held various positions within the law group at AT&T since joining the company in 1995. Prior to that time, Mr. Feit was employed by Shearman & Sterling in its New York and London offices in the corporate finance practice area from 1987 on. Mr. Feit graduated from the University of Pennsylvania Wharton School with a B.S. in Finance in 1984 and from the Law School with a J.D. in 1987.

2003 ANNUAL REPORT

Business Continuity



Local & Long Distance

Application-Aware Network/VPN

Voice Over IP

CAN YOUR NETWORK DO THIS?

AT&T

The world's networking company℠

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Shareowners of AT&T Corp:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, changes in shareowners' equity and cash flows, present fairly, in all material respects, the financial position of AT&T Corp. and its subsidiaries (AT&T) at December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 3 to the financial statements, AT&T changed the manner in which it accounts for variable interest entities as of July 1, 2003, the manner in which it accounts for asset retirement costs as of January 1, 2003, the manner in which it accounts for goodwill and other intangible assets as of January 1, 2002, and the manner in which it accounts for derivative instruments as of January 1, 2001.

PricewaterhouseCoopers LLP

Florham Park, New Jersey
March 5, 2004

AT&T CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Years Ended December 31,		
	2003	2002	2001
	(Dollars in millions, except per share amounts)		
Revenue	$34,529	$ 37,827	$42,197
Operating Expenses			
Access and other connection	10,797	10,790	12,085
Costs of services and products (excluding depreciation of $3,508, $3,391 and $2,954 included below)	7,625	8,363	8,621
Selling, general and administrative	7,379	7,988	8,064
Depreciation and amortization	4,870	4,888	4,559
Net restructuring and other charges	201	1,437	1,036
Total operating expenses	30,872	33,466	34,365
Operating income	3,657	4,361	7,832
Other income (expense), net	191	(77)	1,327
Interest (expense)	(1,158)	(1,448)	(1,493)
Income from continuing operations before income taxes, minority interest income and net (losses) related to equity investments	2,690	2,836	7,666
(Provision) for income taxes	(816)	(1,587)	(2,890)
Minority interest income	1	114	131
Equity (losses) from Liberty Media Group	—	—	(2,711)
Net (losses) related to other equity investments	(12)	(400)	(4,836)
Income (loss) from continuing operations	1,863	963	(2,640)
Net (loss) from discontinued operations (net of income tax benefits of $0, $6,014 and $3,715)	(13)	(14,513)	(4,052)
Gain on disposition of discontinued operations (net of income tax benefit of $61 in 2002)	—	1,324	13,503
Income (loss) before cumulative effect of accounting changes	1,850	(12,226)	6,811
Cumulative effect of accounting changes (net of income taxes of $(9), $530 and $(578))	15	(856)	904
Net income (loss)	1,865	(13,082)	7,715
Dividend requirements of preferred stock	—	—	(652)
Premium on exchange of AT&T Wireless tracking stock	—	—	(80)
Income (loss) attributable to common shareowners	$ 1,865	$(13,082)	$ 6,983
AT&T Common Stock Group — per basic share:			
Earnings (loss) from continuing operations	$ 2.37	$ 1.29	$ (0.91)
(Loss) from discontinued operations	(0.02)	(19.44)	(5.60)
Gain on disposition of discontinued operations	—	1.77	18.53
Cumulative effect of accounting changes	0.02	(1.15)	0.49
AT&T Common Stock Group earnings (loss)	$ 2.37	$ (17.53)	$ 12.51
AT&T Common Stock Group — per diluted share:			
Earnings (loss) from continuing operations	$ 2.36	$ 1.26	$ (0.91)
(Loss) from discontinued operations	(0.02)	(18.95)	(5.60)
Gain on disposition of discontinued operations	—	1.73	18.53
Cumulative effect of accounting changes	0.02	(1.12)	0.49
AT&T Common Stock Group earnings (loss)	$ 2.36	$ (17.08)	$ 12.51
AT&T Wireless Group — per basic and diluted share:			
Earnings	$ —	$ —	$ 0.08
Liberty Media Group — per basic and diluted share:			
(Loss) before cumulative effect of accounting changes	$ —	$ —	$ (1.05)
Cumulative effect of accounting changes	—	—	0.21
Liberty Media Group (loss)	$ —	$ —	$ (0.84)

The notes are an integral part of the consolidated financial statements.

AT&T CORP. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	At December 31, 2003	At December 31, 2002
	(Dollars in millions)	
Assets		
Cash and cash equivalents	$ 4,353	$ 8,014
Accounts receivable, less allowances of $579 and $669	4,036	5,286
Deferred income taxes	715	1,075
Other current assets	744	1,693
Total Current Assets	9,848	16,068
Property, plant and equipment, net	24,376	25,604
Goodwill	4,801	4,626
Other purchased intangible assets, net of accumulated amortization of $320 and $244	499	556
Prepaid pension costs	3,861	3,596
Other assets	4,603	4,987
Total Assets	$ 47,988	$ 55,437
Liabilities		
Accounts payable and accrued expenses	$ 3,256	$ 3,819
Compensation and benefit-related liabilities	1,783	1,949
Debt maturing within one year	1,343	3,762
Other current liabilities	2,501	2,924
Total Current Liabilities	8,883	12,454
Long-term debt	13,066	18,812
Long-term compensation and benefit-related liabilities	3,528	4,144
Deferred income taxes	5,395	3,992
Other long-term liabilities and deferred credits	3,160	3,723
Total Liabilities	34,032	43,125
Shareowners' Equity		
AT&T Common Stock, $1 par value, authorized 6,000,000,000 shares; issued and outstanding 791,911,022 shares (net of 172,179,303 treasury shares) at December 31, 2003 and 783,037,580 shares (net of 171,801,716 treasury shares) at December 31, 2002	792	783
Additional paid-in capital	27,722	28,163
Accumulated deficit	(14,707)	(16,566)
Accumulated other comprehensive income (loss)	149	(68)
Total Shareowners' Equity	13,956	12,312
Total Liabilities and Shareowners' Equity	$ 47,988	$ 55,437

The notes are an integral part of the consolidated financial statements.

AT&T CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREOWNERS' EQUITY

	For the Years Ended December 31,		
	2003	2002	2001
	(Dollars in millions)		
AT&T Common Stock			
Balance at beginning of year	$ 783	$ 708	$ 752
Shares issued (acquired), net:			
Under employee plans	7	6	3
For acquisitions	—	—	9
Settlement of put option	—	—	31
For exchange of AT&T Wireless tracking stock	—	—	(74)
For funding AT&T Canada obligation	—	46	—
Redemption of TCI Pacific preferred stock	—	10	—
Other	2	13	(13)
Balance at end of year	792	783	708
AT&T Wireless Group Common Stock			
Balance at beginning of year	—	—	362
Shares issued:			
Under employee plans	—	—	2
For exchange of AT&T Wireless tracking stock	—	—	438
Conversion of preferred stock	—	—	406
AT&T Wireless Group split-off	—	—	(1,208)
Balance at end of year	—	—	—
Liberty Media Group Class A Common Stock			
Balance at beginning of year	—	—	2,364
Shares issued (acquired), net	—	—	14
Liberty Media Group split-off	—	—	(2,378)
Balance at end of year	—	—	—
Liberty Media Group Class B Common Stock			
Balance at beginning of year	—	—	206
Shares issued (acquired), net	—	—	6
Liberty Media Group split-off	—	—	(212)
Balance at end of year	—	—	—
Additional Paid-In Capital			
Balance at beginning of year	28,163	54,798	93,504
Shares issued (acquired), net:			
Under employee plans	123	328	291
For acquisitions	—	—	862
Settlement of put option	—	—	3,361
For funding AT&T Canada obligation	—	2,485	—
Redemption of TCI Pacific preferred stock	—	2,087	—
Other*	36	31	(1,054)
Gain on issuance of common stock by affiliates	—	—	20
Conversion of preferred stock	—	—	9,631
AT&T Wireless Group split-off	—	—	(20,955)
Liberty Media Group split-off	—	—	(30,768)
AT&T Broadband spin-off	—	(31,032)	—
Exchange of AT&T Wireless tracking stock	—	—	(284)

(continued on next page)

AT&T CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREOWNERS' EQUITY — (Continued)

	For the Years Ended December 31,		
	2003	2002	2001
	(Dollars in millions)		
Beneficial conversion value of preferred stock	—	—	295
Dividends declared — AT&T Common Stock Group	(670)	(569)	(265)
Other	70	35	160
Balance at end of year	27,722	28,163	54,798
(Accumulated Deficit) Retained Earnings			
Balance at beginning of year	(16,566)	(3,484)	7,408
Net income (loss)	1,865	(13,082)	7,715
Dividends declared — AT&T Common Stock Group	—	—	(275)
Dividends accrued — preferred stock	—	—	(652)
Premium on exchange of AT&T Wireless tracking stock	—	—	(80)
Treasury shares issued at less than cost	(6)	—	(7)
AT&T Wireless Group split-off	—	—	(17,593)
Balance at end of year	(14,707)	(16,566)	(3,484)
Accumulated Other Comprehensive Income (Loss)			
Balance at beginning of year	(68)	(342)	(1,398)
Other comprehensive income	217	266	1,742
AT&T Wireless Group split-off	—	—	72
Liberty Media Group split-off	—	—	(758)
AT&T Broadband spin-off	—	8	—
Balance at end of year	149	(68)	(342)
Total Shareowners' Equity	$ 13,956	$ 12,312	$ 51,680
Summary of Total Comprehensive Income (Loss):			
Income (loss) before cumulative effect of accounting changes	1,850	(12,226)	6,811
Cumulative effect of accounting changes	15	(856)	904
Net income (loss)	1,865	(13,082)	7,715
Other comprehensive income [net of income taxes of $(134), $(169) and $(1,119)]	217	266	1,742
Total Comprehensive Income (Loss)	$ 2,082	$(12,816)	$ 9,457

AT&T accounts for treasury stock as retired stock. The amounts attributable to treasury stock at December 31, 2003 and 2002, were $(17,026) million and $(17,037) million, respectively.

We have 100 million authorized shares of preferred stock at $1 par value.

* Other activity in 2001 represents AT&T common stock received in exchange for entities owning certain cable systems.

The notes are an integral part of the consolidated financial statements.

AT&T CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,		
	2003	2002	2001
	(Dollars in millions)		
Operating Activities			
Net income (loss)	$ 1,865	$(13,082)	$ 7,715
Deduct:			
Loss from discontinued operations	(13)	(14,513)	(4,052)
Gain on disposition of discontinued operations	—	1,324	13,503
Cumulative effect of accounting changes — net of income taxes	15	(856)	904
Income (loss) from continuing operations	1,863	963	(2,640)
Adjustments to reconcile income (loss) from continuing operations to net cash provided by operating activities of continuing operations:			
Net gains on sales of businesses and investments	(53)	(30)	(1,231)
Cost investment impairment charges	2	146	531
Net restructuring and other charges	93	1,418	973
Depreciation and amortization	4,870	4,888	4,559
Provision for uncollectible receivables	703	1,058	884
Deferred income taxes	1,402	2,631	(1,338)
Net revaluation of certain financial instruments	7	8	(150)
Minority interest income	(1)	(114)	(131)
Equity losses from Liberty Media Group	—	—	2,711
Net (earnings) losses related to other equity investments	(19)	512	7,783
Decrease in receivables	600	707	888
Decrease in accounts payable and accrued expenses	(494)	(175)	(508)
Net change in other operating assets and liabilities	(256)	(1,400)	(2,126)
Other adjustments, net	(187)	(129)	(200)
Net Cash Provided by Operating Activities of Continuing Operations	8,530	10,483	10,005
Investing Activities			
Capital expenditures and other additions	(3,157)	(3,878)	(5,767)
Proceeds from sale or disposal of property, plant and equipment	163	468	73
Investment distributions and sales	126	10	1,585
Investment contributions and purchases	(51)	(2)	(101)
Net (acquisitions) dispositions of businesses, net of cash acquired/disposed	(158)	(18)	15
Decrease in AT&T Canada obligation	—	(3,449)	—
Proceeds from AT&T Broadband	—	5,849	—
Increase in restricted cash	(57)	(442)	—
Other investing activities, net	33	33	(100)
Net Cash Used in Investing Activities of Continuing Operations	(3,101)	(1,429)	(4,295)
Financing Activities			
Proceeds from long-term debt issuances, net of issuance costs	—	79	11,392
Retirement of long-term debt, including redemption premiums	(8,002)	(1,091)	(725)
Decrease in short-term borrowings, net	(1,281)	(7,157)	(17,168)
Repayment of borrowings from AT&T Wireless	—	—	(5,803)
Issuance of convertible preferred securities and warrants	—	—	9,811
Issuance of AT&T common shares	118	2,684	224
Issuance of AT&T Wireless Group common shares	—	—	54
Net issuance of treasury shares	—	—	24
Dividends paid on common stock	(629)	(555)	(549)
Other financing activities, net	704	(1)	(38)
Net Cash Used in Financing Activities of Continuing Operations	(9,090)	(6,041)	(2,778)
Net cash (used in) provided by discontinued operations	—	(5,679)	7,683
Net (decrease) increase in cash and cash equivalents	(3,661)	(2,666)	10,615
Cash and cash equivalents at beginning of year	8,014	10,680	65
Cash and cash equivalents at end of year	$ 4,353	$ 8,014	$ 10,680

The notes are an integral part of the consolidated financial statements.

AT&T CORP. AND SUBSIDIARIES (AT&T)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements include all controlled subsidiaries. In addition, AT&T reviews our relationships with other entities to assess if we are the primary beneficiary of a variable interest entity. If the determination is made that we are the primary beneficiary, then that entity is consolidated. All significant intercompany accounts and transactions have been eliminated in consolidation. Investments in majority-owned subsidiaries where control does not exist and investments in which we exercise significant influence but do not control (generally a 20% to 50% ownership interest) are accounted for under the equity method of accounting. Investments in which there is no significant influence (generally less than a 20% ownership interest) are accounted for under the cost method of accounting.

Foreign Currency Translation

For operations outside the United States that prepare financial statements in currencies other than the U.S. dollar, we translate income statement amounts at average exchange rates for the year, and we translate assets and liabilities at year-end exchange rates. We present these translation adjustments as a component of accumulated other comprehensive income (loss) within shareowners' equity. Gains and losses from foreign currency transactions are included in results of operations.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and revenue and expenses during the period reported. Actual results could differ from those estimates. Estimates are used when accounting for certain items, such as allowances for doubtful accounts, access and local connectivity costs, depreciation and amortization, employee benefit plans, income taxes, restructuring reserves, recoverability of goodwill and contingencies.

Revenue Recognition

We recognize long distance, local voice and data services revenue based upon minutes of traffic processed or contracted fee schedules. In addition, we record an estimated revenue reduction for adjustments to customer accounts. This estimate is based on a detailed analysis that compares accounts receivable aging at different points in time to determine the appropriate level of adjustments. Cash incentives given to customers are recorded as a reduction of revenue. We recognize other products and services revenue when the products are delivered and accepted by customers and when services are provided in accordance with contract terms. When installation and set-up fees are billed, the revenue is deferred and recognized over the associated service contract period. For contracts that involve the bundling of services, revenue is allocated to the services based on their relative fair value. AT&T records the sale of equipment to customers gross when the equipment will be used in conjunction with the provisioning of our services and we are the primary obligor in the arrangement. For contracts where we provide customers with an indefeasible right to use network capacity, we recognize revenue ratably over the stated life of the agreement. For agreements involving the resale of third party services in which AT&T is not considered the primary obligor of the arrangement, AT&T records the revenue net of the associated costs incurred.

Advertising and Promotional Costs

We expense costs of advertising and promotions as incurred.

Income Taxes

The provision for income taxes is based on reported income before income taxes. Deferred income taxes are provided for the effect of temporary differences between the amounts of assets and liabilities recognized for financial reporting purposes and the amounts recognized for income tax purposes. Deferred tax assets and liabilities are measured using currently enacted tax laws and the effects of any changes in income tax laws are included in the provision for income taxes in the period of enactment. Valuation allowances are recognized to reduce deferred tax assets when it is more likely than not that the asset will not be realized. In assessing the likelihood of realization, we consider estimates of future taxable income, the character of income needed to realize future benefits and all available evidence. Investment tax credits are amortized as a reduction to the provision for income taxes over the useful lives of the assets that produced the credits.

Cash Equivalents

We consider all highly liquid investments with original maturities of three months or less to be cash equivalents.

Property, Plant and Equipment

We state property, plant and equipment at cost. Construction costs, labor and applicable overhead related to installations and interest during construction are capitalized. Costs of additions and substantial improvements to property, plant and equipment are capitalized. The costs of maintenance and repairs of property, plant and equipment are charged to operating expense. The useful lives of communications and network equipment range from three to 15 years. The useful lives of other equipment ranges from three to seven years. The useful lives of buildings and improvements range from 10 to 40 years. Depreciation is determined based upon the assets' estimated useful lives using either the group or unit method. The group method is used for most depreciable assets, including the majority of communications and network equipment. The unit method is primarily used for large computer systems, buildings and support assets. Under the group method, a specific asset group has an average life. A depreciation rate is developed based on the average useful life for the specific asset group. This method requires the periodic revision of depreciation rates. Under the unit method, assets are depreciated on a straight-line basis over the estimated useful life of the individual asset. When we sell or retire assets depreciated using the group method, the difference between the proceeds, if any, and the cost of the asset is charged or credited to accumulated depreciation, without recognition of a gain or loss. When we sell assets that were depreciated using the unit method, we include the related gains or losses in other income (expense), net.

Property, plant and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. If the total of the expected future undiscounted cash flows is less than the carrying value of the asset, a loss is recognized for the difference between the fair value and the carrying value of the asset.

Software Capitalization

Certain direct development costs associated with internal-use software are capitalized, including external direct costs of material and services, and payroll costs for employees devoting time to the software projects. These costs are included within other assets and are amortized over a period not to exceed three years beginning when the asset is substantially ready for use. Costs incurred during the preliminary project stage, as well as maintenance and training costs, are expensed as incurred. AT&T also capitalizes initial operating-system software costs and amortizes them over the life of the associated hardware.

Goodwill and Other Intangible Assets

Goodwill is the excess of the purchase price over the fair value of net assets acquired in business combinations accounted for under the purchase method. Beginning January 1, 2002, in accordance with Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," goodwill and indefinite-lived intangible assets are no longer amortized, but instead are tested for impairment at least annually. Intangible assets that have finite useful lives are amortized over their useful lives, which range from five to 15 years.

Derivative Financial Instruments and Hedging Activities

We use derivative financial instruments to mitigate market risk from changes in interest rates, foreign currency exchange rates and equity prices. Derivative financial instruments may be exchange-traded or contracted in the over-the-counter market and include swaps, options, warrants and forward contracts. We do not use derivative financial instruments for speculative purposes.

All derivatives are recognized on the balance sheet at fair value. Certain derivatives, at inception, are designated as hedges and evaluated for effectiveness at least quarterly throughout the hedge period. These derivatives are designated as either (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (fair value hedge), or (2) a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge). All other derivatives are not formally designated for accounting purposes (undesignated). These derivatives, except for warrants, although undesignated for accounting purposes, are entered into to hedge economic risks.

We record changes in the fair value of fair-value hedges, along with the changes in the fair value of the hedged asset or liability that is attributable to the hedged risk (including losses or gains on firm commitments), in other income (expense), net.

We record changes in the fair value of cash-flow hedges in other comprehensive income (loss), net of income taxes, as a component of shareowners' equity, until earnings are affected by the variability of cash flows of the hedged transaction.

Changes in the fair value of undesignated derivatives are recorded in other income (expense), net, along with the change in fair value of the underlying asset or liability, as applicable.

We currently do not have any net investment hedges in a foreign operation.

Cash flows associated with derivative instruments are presented in the same category as the cash flows of the item being hedged.

We assess embedded derivatives to determine whether (1) the economic characteristics of the embedded instruments are not clearly and closely related to the economic characteristics of the remaining component of the financial instrument (the host instrument) and (2) whether the embedded instrument meets the definition of a derivative instrument. When it is determined that both conditions exist, we designate the derivatives as described above, and recognize the derivative at fair value.

We formally document all relationships between hedging instruments and hedged items, as well as the risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions.

We discontinue hedge accounting prospectively when (1) it is determined that the derivative is no longer effective in offsetting changes in the fair value or cash flows of a hedged item, (2) the derivative or hedged item expires or is sold, terminated, or exercised, (3) it is determined that the forecasted hedged transaction will no longer occur, (4) a hedged firm commitment no longer meets the definition of a firm commitment, or (5) management determines that the designation of the derivative as a hedge instrument is no longer appropriate.

When hedge accounting is discontinued, the derivative is adjusted for changes in fair value through other income (expense), net. For fair value hedges, the underlying asset or liability will no longer be adjusted for changes in fair value and any asset or liability recorded in connection with the hedging relationship (including firm commitments) will be removed from the balance sheet and recorded in current period earnings. For cash flow hedges, gains and losses that were accumulated in other comprehensive income (loss) as a component of shareowners' equity in connection with hedged assets or liabilities or forecasted transactions will be recognized in other income (expense), net in the same period the hedged item affects earnings.

Stock-Based Compensation

AT&T has a Long-Term Incentive Program under which AT&T grants stock options, performance shares, restricted stock and other awards in AT&T common stock, and an Employee Stock Purchase Plan, which are described more fully in note 12. Effective January 1, 2003, we adopted the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," and we began to record stock-based compensation expense for all employee awards (including stock options) granted or modified after January 1, 2003. For awards issued prior to January 1, 2003, we apply Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for our plans. Under APB Opinion No. 25, no compensation expense has been recognized other than for our performance-based and restricted stock awards, stock appreciation rights (SARs), and certain occasions when we have modified the terms of the stock option vesting schedule.

If AT&T had elected to recognize compensation costs based on the fair value at the date of grant of all awards granted prior to January 1, 2003, consistent with the provisions of SFAS No. 123, net income (loss) and earnings (loss) per share amounts would have been as follows:

	AT&T Common Stock Group[1]			AT&T Wireless Group
	For the Years Ended December 31,			
	2003	2002	2001	2001
	(Dollars in millions, except per share amounts)			
Net income (loss)	$1,865	$(13,082)	$9,114	$ 35
Add:				
Stock-based employee compensation included in reported results from continuing operations, net of income taxes	75	55	71	—
Stock-based employee compensation included in reported results from discontinued operations, net of income taxes	—	44	14	—
Deduct:				
Total stock-based compensation expense determined under the fair value method for all awards relating to continuing operations, net of income taxes	(225)	(288)	(562)	—
Total stock-based compensation expense determined under the fair value method for all awards relating to discontinued operations, net of income taxes	—	(113)	(140)	(17)
Pro forma net income (loss)	$1,715	$(13,384)	$8,497	$ 18
Basic earnings (loss) per share	$ 2.37	$ (17.53)	$12.51	$0.08
Pro forma basic earnings (loss) per share	$ 2.18	$ (17.93)	$11.66	$0.04
Diluted earnings (loss) per share	$ 2.36	$ (17.08)	$12.51	$0.08
Pro forma diluted earnings (loss) per share	$ 2.17	$ (17.47)	$11.66	$0.04

(1) AT&T Common Stock Group's results exclude amounts attributable to Liberty Media Group and AT&T Wireless Group tracking stocks.

Pro forma stock-based compensation expense reflected above may not be indicative of future compensation expense that may be recorded. Future compensation expense may differ due to various factors, such as the number of awards granted and the market value of such awards at the time of grant.

Pro forma earnings (loss) for AT&T Common Stock Group from continuing operations was $1,713 million, $730 million and $(1,152) million for 2003, 2002 and 2001, respectively, and from discontinued operations was $(13) million, $(14,582) million and $(4,213) million for 2003, 2002 and 2001, respectively.

Pro forma earnings (loss) for AT&T Common Stock Group per basic share from continuing operations was $2.18, $0.98 and $(1.58) for 2003, 2002 and 2001, respectively, and from discontinued operations was $(0.02), $(19.53) and $(5.78) for 2003, 2002 and 2001, respectively.

Pro forma earnings (loss) for AT&T Common Stock Group per diluted share from continuing operations was $2.17, $0.96 and $(1.58) for 2003, 2002 and 2001, respectively, and from discontinued operations was $(0.02), $(19.04) and $(5.78) for 2003, 2002 and 2001, respectively.

The pro forma effect on net loss from discontinued operations for AT&T Common Stock Group for 2002 includes expense of $28 million due to the accelerated vesting of AT&T stock options held by AT&T Broadband employees at the date of spin-off. The pro forma effect on net loss from discontinued operations for AT&T Common Stock Group for 2001 includes expense of $10 million due to the conversion of AT&T common stock options in connection with the split-off of AT&T Wireless, and also includes expense of $12 million due to the accelerated vesting of AT&T Wireless stock options held by AT&T employees at the date of the split-off.

The pro forma effect on net loss from continuing operations for AT&T Common Stock Group available to common shareowners for 2001 includes expense of $40 million due to the conversion of AT&T common stock options in connection with the split-off of AT&T Wireless, and also includes expense of $163 million due to the accelerated vesting of AT&T Wireless stock options held by AT&T employees at the date of split-off.

Employee Separations

In accordance with SFAS No. 112, "Employers' Accounting for Postemployment Benefits," AT&T establishes postemployment benefit obligations for expected terminations provided to former or inactive employees after employment but before retirement. These benefits include severance payments, medical coverage, and other benefits.

Issuance of Common Stock by Affiliates

Changes in our proportionate share of the underlying equity of a subsidiary or equity method investee, which result from the issuance of additional equity securities by such entity, are recognized as increases or decreases to additional paid-in capital as a component of shareowners' equity.

Concentrations

As of December 31, 2003, other than the guarantee issued in connection with the split-off of AT&T Wireless (see note 9), we do not have any significant concentration of business transacted with a particular customer, supplier, lender or former affiliate that could, if suddenly adversely impacted, severely impact our operations. We also do not have a concentration of available sources of labor, services or other rights that could, if suddenly eliminated, severely impact our operations. We invest our cash with many high-quality credit institutions.

Reclassifications and Restatements

We reclassified certain amounts for previous years to conform to the 2003 presentation.

2. AT&T Restructuring and Discontinued Operations

In connection with the restructuring of AT&T announced on October 25, 2000, AT&T Broadband, AT&T Wireless, and Liberty Media Group have all been separated from AT&T.

AT&T Broadband, which was spun-off from AT&T on November 18, 2002, was accounted for as a discontinued operation pursuant to SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." AT&T Wireless, which was split-off from AT&T on July 9, 2001, was accounted for as a discontinued operation pursuant to APB Opinion No. 30, "Reporting Results of Operations — Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." As discontinued operations, the revenue, expenses and cash flows of AT&T Broadband and AT&T Wireless are excluded from the respective captions in the Consolidated Statements of Operations and Consolidated Statements of Cash Flows, and are reported through their respective dates of separation as net (loss) from discontinued operations and as net cash (used in) provided by discontinued operations.

AT&T Broadband

On November 18, 2002, AT&T spun-off AT&T Broadband, which was comprised primarily of the AT&T Broadband segment, to AT&T shareowners. Simultaneously, AT&T Broadband combined with Comcast Corporation (Comcast). The combination was accomplished through a distribution of stock to AT&T shareowners, who received 1.6175 shares of Comcast Class A common stock for each share of AT&T they owned at market close on November 15, 2002, the record date. The Internal Revenue Service (IRS) ruled that the transaction qualified as tax-free for AT&T and our shareowners for U.S. federal income tax purposes, with the exception of cash received for fractional shares. Approximately 1.2 billion Comcast shares were issued to AT&T shareowners at a value of approximately $31.1 billion, based on the Comcast stock price on November 18, 2002. AT&T shareowners received a 56% economic stake and a 66% voting interest in Comcast.

In connection with the non-pro rata spin-off of AT&T Broadband, AT&T wrote up the net assets of AT&T Broadband to fair value. This resulted in a noncash gain on disposition of $1.3 billion, which represented the difference between the fair value of the AT&T Broadband business at the date of the spin-off and AT&T's book value of AT&T Broadband, net of certain charges triggered by the spin-off and their related income tax effect. These charges included compensation expense due to accelerated vesting of stock options, as well as the enhancement of certain incentive plans.

Revenue for AT&T's Broadband business (which included At Home Corporation through September 2001) was $8.9 billion and $10.1 billion for 2002 and 2001, respectively. Net (loss) from discontinued operations before income taxes was $(20.5) billion and $(8.1) billion for 2002 and 2001, respectively, for the AT&T Broadband business. The loss for 2002 included pretax impairment charges of $16.5 billion ($11.8 billion after taxes) relating to goodwill and franchise costs which were recorded in the second quarter of 2002.

Interest expense of $359 million and $333 million was allocated to AT&T Broadband in 2002 and 2001, respectively, based on the balance of intercompany debt between AT&T Broadband and AT&T. At the time of the spin-off of AT&T Broadband, this intercompany debt was settled via a $5.8 billion cash distribution from AT&T Broadband and the exchange of $3.5 billion of AT&T notes for notes of AT&T Broadband which are unconditionally guaranteed by Comcast and certain of its subsidiaries.

The noncash impacts of the spin-off of AT&T Broadband include a reduction to assets of approximately $84.3 billion, a reduction to liabilities of approximately $48.8 billion, the reduction of minority interest of $1.2 billion, the reduction of company-obligated convertible quarterly income preferred securities of subsidiary trust of $4.7 billion, and a reduction to shareowners' equity of approximately $29.6 billion, including the $1.3 billion noncash gain on spin-off.

AT&T Wireless

AT&T issued AT&T Wireless tracking stock in April 2000, which was intended to track the financial performance and economic value of AT&T Wireless Group. The shares initially tracked approximately 16% of the financial performance of AT&T Wireless Group. On May 25, 2001, AT&T completed an exchange offer of AT&T common stock for AT&T Wireless stock. Under the terms of the exchange offer, AT&T issued 5.88 shares of AT&T Wireless Group tracking stock in exchange for each share of AT&T common stock validly tendered. A total of 74.4 million shares of AT&T common stock were tendered in exchange for 437.7 million shares of AT&T Wireless Group tracking stock. In conjunction with the exchange offer, AT&T recorded an $80 million premium as a reduction to net income available to common shareowners. The premium represented the excess of the fair value of the AT&T Wireless Group tracking stock issued over the fair value of the AT&T common stock exchanged.

On July 9, 2001, AT&T completed the split-off of AT&T Wireless as a separate, independently traded company. All AT&T Wireless Group tracking stock was converted into AT&T Wireless common stock on a one-for-one basis, and 1,136 million shares of AT&T Wireless common stock held by AT&T were distributed to AT&T common shareowners on a basis of 1.609 shares of AT&T Wireless for each AT&T share outstanding. AT&T common shareowners received whole shares of AT&T Wireless common stock and cash payments for fractional shares. The IRS ruled that the transaction qualified as tax-free for AT&T and its shareowners for U.S. federal income tax purposes, with the exception of cash received for fractional shares. The split-off of AT&T Wireless resulted in a tax-free noncash gain on disposition of discontinued operations of $13.5 billion, which represented the difference between the fair value of the AT&T Wireless tracking stock at the date of the split-off and AT&T's book value of AT&T Wireless.

Revenue for AT&T Wireless was $6.6 billion for 2001. Income from discontinued operations before income taxes for AT&T Wireless was $308 million for 2001. Interest expense of $153 million was allocated to AT&T Wireless in 2001, based on the debt of AT&T that was attributable to AT&T Wireless.

The noncash impacts of the split-off of AT&T Wireless reflect the split-off of approximately $39.7 billion of net assets which included the $13.5 billion noncash gain on disposition.

NCR Corp.

Net (loss) from discontinued operations for 2003 represents an estimated cost related to potential legal liabilities for certain environmental clean-up matters associated with NCR Corp. (NCR), which was spun-off from AT&T in 1996. NCR has been formally notified by federal and state agencies that it is a potentially responsible party (PRP) for environmental claims under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) and other statutes arising out of the presence of polychlorinated biphenyls (PCBs) in sediments in the lower Fox River and in the Bay of Green Bay in Wisconsin. NCR was identified as a PRP because of alleged PCB discharges from two carbonless copy paper manufacturing facilities it previously owned, which were located along the Fox River. In July 2003, the government clarified its planned approach for remediation of the contaminated sediments, which caused NCR to increase its estimated liability. Under the separation and distribution agreement between AT&T and NCR, AT&T is required to pay a portion of such costs that NCR incurs above a certain threshold. Therefore, in 2003, we recorded our estimated proportionate share of certain costs associated with the Fox River matter, which totaled $13 million on both a pretax and after-tax basis. The extent of NCR's potential liability is subject to numerous variables that are uncertain at this time, including the actual remediation costs and the percentage NCR may ultimately be responsible for. As a result, AT&T's actual liability may be different than the estimated amount. Pursuant to the separation and distribution agreement, NCR is liable for the first $100 million of costs in connection with this liability. AT&T is liable for 37% of costs incurred by NCR beyond such $100 million threshold. All such amounts are determined after reduction of any monies collected by NCR from other parties.

Lucent Technologies Inc.

Net (loss) from discontinued operations for 2002 included an estimated loss on a litigation settlement associated with the business of Lucent Technologies Inc. (Lucent), which was spun-off from AT&T in 1996. Sparks, et al. v. AT&T and Lucent et al., was a class action lawsuit filed in 1996 in Illinois state court. The complaint sought damages on behalf of present and former customers based on a claim that the AT&T Consumer Products business (which became part of Lucent in 1996) and Lucent had defrauded and misled customers who leased telephones, resulting in payments in excess of the cost to purchase the telephones. On August 9, 2002, a settlement proposal was submitted to and accepted by the court. In accordance with the separation and distribution agreement between AT&T and Lucent, AT&T's estimated proportionate share of the settlement and legal costs totaled $45 million pretax ($33 million after taxes). Depending upon the number of claims submitted and accepted, the actual cost of the settlement to AT&T may be different than the amounts accrued. While similar consumer class actions are pending in various state courts, the Illinois state court has held that the class it certified covers claims in the other state court class actions.

Summary

Following is a summary of net (loss) from discontinued operations, net of income taxes:

	For the Years Ended December 31,		
	2003	2002	2001
	(Dollars in millions)		
AT&T Broadband, net of income tax benefits of $6,002 and $3,873	$ —	$(14,480)	$(4,202)
AT&T Wireless, net of income taxes of $(158)	—	—	150
NCR, net of income taxes of $0	(13)	—	—
Lucent, net of income tax benefit of $12	—	(33)	—
Net (loss) from discontinued operations, net of income taxes	$(13)	$(14,513)	$(4,052)

Liberty Media Group

As a result of our merger with Tele-Communications, Inc. (TCI) in 1999, we acquired Liberty Media Group (LMG). Although LMG was wholly owned, we accounted for it as an equity method investment since we did not have a controlling financial interest. On August 10, 2001, AT&T completed the split-off of Liberty Media Corporation as an independent, publicly-traded company. AT&T redeemed each outstanding share of Class A and Class B LMG tracking stock for one share of Liberty Media Corporation's Series A and Series B common stock, respectively. The IRS ruled that the split-off of Liberty Media Corporation qualified as a tax-free transaction for AT&T, Liberty Media and their shareowners. The operating results of LMG through July 31, 2001, the deemed effective split-off date for accounting purposes, are reflected as equity (losses) from Liberty Media Group. At the time of disposition, AT&T did not exit the line of business that Liberty Media Group operated in; therefore, at the time of its separation, Liberty Media Group was not accounted for as a discontinued operation.

Upon split-off, AT&T paid LMG $803 million pursuant to a tax-sharing agreement related to TCI net operating losses generated prior to AT&T's merger with TCI. In addition, in 2002, AT&T received approximately $114 million from LMG related to taxes pursuant to a tax-sharing agreement between LMG and AT&T Broadband, which existed prior to the TCI merger.

Summarized results of operations for LMG were as follows:

	For the Seven Months Ended July 31, 2001
	(Dollars in millions)
Revenue	$ 1,190
Operating (loss)	(426)
(Loss) from continuing operations before cumulative effect of accounting change	(2,711)
Cumulative effect of accounting change	545
Net (loss)	(2,166)

3. Impacts of Recently Adopted Accounting Pronouncements

Financial Accounting Standards Board Interpretation (FIN) No. 46, "Consolidation of Variable Interest Entities — an Interpretation of Accounting Research Bulletin No. 51"

Effective July 1, 2003, AT&T early adopted FIN No. 46, "Consolidation of Variable Interest Entities — an Interpretation of Accounting Research Bulletin No. 51." This interpretation requires the primary beneficiary to consolidate a variable interest entity (VIE) if it has a variable interest that will absorb a majority of the entity's expected losses if they occur, receive a majority of the entity's expected residual returns if they occur, or both. Based on the new standard, two entities that AT&T leased buildings from qualified as VIEs and, therefore, became subject to consolidation as of July 1, 2003. AT&T had no ownership interest in either entity, but provided guarantees of the residual values for the leased facilities with a maximum exposure of $427 million. Upon adoption, FIN No. 46 added approximately $433 million of assets (included in property, plant and equipment of AT&T Business Services and Corporate and Other group) and $477 million of liabilities (included in short-term debt) to our consolidated balance sheet, which resulted in a charge of $27 million after taxes ($44 million pretax) as the cumulative effect of an accounting change in the third quarter of 2003. In November 2003, AT&T exercised its purchase option on these leased buildings and thus repaid the associated debt. The noncash impact of the adoption of this interpretation on the balance sheet at December 31, 2003, includes a $433 million increase in property, plant and equipment.

SFAS No. 143, "Accounting for Asset Retirement Obligations"

Effective January 1, 2003, AT&T adopted SFAS No. 143, "Accounting for Asset Retirement Obligations." This standard requires that obligations that are legally enforceable and unavoidable, and are associated with the retirement of tangible long-lived assets, be recorded as liabilities when those obligations are incurred, with the amount of the liability initially measured at fair value. The offset to the initial asset retirement obligation is an increase in the carrying amount of the related long-lived asset. Over time, this liability is accreted to its future value, and the asset is depreciated over its useful life. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement.

AT&T historically included in its group depreciation rates an amount related to the cost of removal for certain assets. However, such amounts are not legally enforceable or unavoidable; therefore, upon adoption of SFAS No. 143, AT&T reversed the amount previously accrued in accumulated depreciation. As of January 1, 2003, AT&T recorded income of $42 million as the cumulative effect of a change in accounting principle, primarily related to this reversal. The impact of no longer including the cost of removal in the group depreciation rates, partially offset by the cumulative effect impact on accumulated depreciation, has resulted in a decrease to depreciation expense in 2003. However, the costs incurred to remove these assets will be reflected in the period incurred within costs of services and products.

SFAS No. 142, "Goodwill and Other Intangible Assets"

Effective January 1, 2002, AT&T adopted SFAS No. 142, "Goodwill and Other Intangible Assets." Upon adoption, goodwill was tested for impairment by comparing the fair value of our reporting units to their carrying values. As of January 1, 2002, the fair value of the reporting units' goodwill exceeded their carrying value, and therefore, no impairment loss was recognized. Franchise costs were tested for impairment as of January 1, 2002, by comparing the fair value to the carrying value (at the market level). An impairment loss of $856 million, net of taxes of $530 million, was recorded relating to the discontinued operation of AT&T Broadband in the first quarter of 2002. At December 31, 2002, this amount is included in the cumulative effect of accounting changes.

The table below presents the impact of SFAS No. 142 on net (loss) income and (loss) earnings per share, had the standard been in effect on January 1, 2001:

	AT&T Common Stock Group		AT&T Wireless Group	Liberty Media Group
	For the Years Ended December 31,			
	2002	2001	2001	2001
	(Dollars in millions, except per share amounts)			
Net (loss) income:				
Reported income (loss) from continuing operations	$ 963	$ 71	$ —	$(2,711)
Dividend requirements of preferred stock	—	(652)	—	—
Premium on exchange of AT&T Wireless tracking stock	—	(80)	—	—
Reported income (loss) from continuing operations available to common shareowners	963	(661)	—	(2,711)
Add back amortization, net of taxes:				
Goodwill	—	175	—	350
Equity method excess basis	—	37	—	346
Franchise costs	—	—	—	4
Adjusted income (loss) from continuing operations available to common shareowners	963	(449)	—	(2,011)
Reported (loss) income from discontinued operations	(14,513)	(4,087)	35	—
Add back discontinued operations amortization, net of taxes	—	1,588	36	—
Gain on disposition of discontinued operations	1,324	13,503	—	—
Cumulative effect of accounting changes	(856)	359	—	545
Adjusted net (loss) income available to common shareowners	$(13,082)	$10,914	$ 71	$(1,466)
Basic (loss) earnings per share:				
Reported basic earnings (loss) per share from continuing operations	$ 1.29	$ (0.91)	$ —	$ (1.05)
Add back amortization, net of taxes:				
Goodwill	—	0.24	—	0.14
Equity method excess basis	—	0.05	—	0.13
Franchise costs	—	—	—	—
Adjusted basic earnings (loss) per share from continuing operations	1.29	(0.62)	—	(0.78)
Reported (loss) earnings from discontinued operations	(19.44)	(5.60)	0.08	—
Add back discontinued operations amortization, net of taxes	—	2.18	0.08	—
Gain on disposition of discontinued operations	1.77	18.53	—	—
Cumulative effect of accounting changes	(1.15)	0.49	—	0.21

	AT&T Common Stock Group		AT&T Wireless Group	Liberty Media Group
	For the Years Ended December 31,			
	2002	2001	2001	2001
	(Dollars in millions, except per share amounts)			
Adjusted basic (loss) earnings per share	$ (17.53)	$ 14.98	$0.16	$ (0.57)
Diluted (loss) earnings per share:				
Reported diluted earnings (loss) per share from continuing operations	$ 1.26	$ (0.91)	$ —	$ (1.05)
Add back amortization, net of taxes:				
Goodwill	—	0.24	—	0.14
Equity method excess basis	—	0.05	—	0.13
Franchise costs	—	—	—	—
Adjusted diluted earnings (loss) per share from continuing operations	1.26	(0.62)	—	(0.78)
Reported (loss) earnings from discontinued operations	(18.95)	(5.60)	0.08	—
Add back discontinued operations amortization, net of taxes	—	2.18	0.08	—
Gain on disposition of discontinued operations	1.73	18.53	—	—
Cumulative effect of accounting changes	(1.12)	0.49	—	0.21
Adjusted diluted (loss) earnings per share	$ (17.08)	$ 14.98	$0.16	$ (0.57)

Adoption of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities"

Effective January 1, 2001, AT&T adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" and its corresponding amendments under SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities." SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheet at fair value. The adoption of SFAS No. 133 on January 1, 2001, resulted in a pretax cumulative-effect increase to income of $1,482 million ($904 million after taxes); $581 million ($359 million after taxes) was attributable to AT&T, excluding LMG, and $901 million ($545 million after taxes) was attributable to LMG.

AT&T's cumulative-effect increase to net income of $359 million, excluding LMG, was comprised of $130 million related to continuing operations primarily attributable to warrants held in both public and private companies, and $229 million related to discontinued operations primarily attributable to embedded and non-embedded net purchase options related to indexed debt instruments.

Upon adoption, AT&T, as permitted by SFAS No. 133, reclassified certain securities from available-for-sale to trading. This reclassification resulted in the recognition, in earnings, of losses previously recorded within accumulated other comprehensive loss. A portion of the loss ($1.6 billion pretax; $1.0 billion after taxes) was recorded as part of the cumulative effect of adoption. This loss completely offset a gain on the indexed debt obligation that had been considered a hedge of Comcast, Microsoft Corporation (Microsoft) and Vodafone plc available-for-sale securities. The reclassification of securities also resulted in a pretax charge of $1.2 billion ($0.7 billion after taxes) recorded in net (loss) from discontinued operations.

LMG's cumulative-effect increase to income of $545 million was primarily attributable to separately recording the embedded call option obligations associated with LMG's senior exchangeable debentures. Also included in the cumulative effect was $87 million previously included in accumulated other comprehensive loss primarily related to changes in the fair value of LMG's warrants and options to purchase certain available-for-sale securities.

4. Supplementary Financial Information

Supplementary Income Statement Information

	For the Years Ended December 31,		
	2003	2002	2001
	(Dollars in millions)		
Included in Selling, General and Administrative Expenses:			
Research and development expenses	$277	$ 254	$ 274
Advertising and promotional expenses	$621	$ 814	$ 874
Other income (expense), net:			
Investment-related income	$177	$ 116	$ 285
Net gains on sales of businesses and investments	53	30	1,231
Settlements associated with businesses disposed of	39	107	154
Loss on early extinguishment of debt	(85)	—	—
Aircraft leveraged lease write-downs	(65)	(244)	—
Net revaluation of certain financial instruments	(7)	(8)	150
Cost investment impairment charges	(2)	(146)	(531)
Miscellaneous, net	81	68	38
Total other income (expense), net	$191	$ (77)	$1,327

Supplementary Balance Sheet Information

	At December 31,	
	2003	2002
	(Dollars in millions)	
Property, plant and equipment:		
Communications, network and other equipment	$49,674	$48,169
Buildings and improvements	8,667	8,129
Land and improvements	335	327
Total property, plant and equipment	58,676	56,625
Accumulated depreciation	34,300	31,021
Property, plant and equipment, net	$24,376	$25,604

	At December 31,	
	2003	2002
	(Dollars in millions)	
Income taxes payable	$472	$362

	AT&T Business Services	AT&T Consumer Services	Total
	(Dollars in millions)		
Goodwill:			
Balance at January 1, 2003	$4,556	$70	$4,626
Translation adjustment	175	—	175
Balance at December 31, 2003	$4,731	$70	$4,801

	Gross Carrying Amount	Accumulated Amortization	Net
	(Dollars in millions)		
Amortizable Other Purchased Intangible Assets:			
Customer lists and relationships	$557	$132	$425
Other	243	112	131
Balance at December 31, 2002	$800	$244	$556
Customer lists and relationships	$548	$162	$386
Other	271	158	113
Balance at December 31, 2003	$819	$320	$499

The amortization expense associated with purchased intangible assets for the years ended December 31, 2003 and 2002, was $71 million and $83 million, respectively. Amortization expense for purchased intangible assets is estimated to be approximately $110 million for the years ending December 31, 2004, 2005 and 2006, and $80 million for each of the years ending December 31, 2007 and 2008.

Leveraged Leases:

We lease airplanes, energy-producing facilities and transportation equipment to third parties under leveraged leases having original terms of 10 to 30 years, expiring in various years from 2006 through 2020. The following is a summary of our investment in leveraged leases, which is primarily included in other assets:

	At December 31, 2003	At December 31, 2002
	(Dollars in millions)	
Rental receivables (net of nonrecourse debt)[1]	$ 456	$ 476
Estimated unguaranteed residual values	359	483
Unearned income	(153)	(211)
Allowance for credit losses	(22)	(23)
Investment in leveraged leases (included in other assets)	640	725
Deferred taxes	877	932
Net investment	$(237)	$(207)

[1] Rental receivables are net of nonrecourse debt of $1.3 billion and $1.4 billion at December 31, 2003 and 2002, respectively.

Supplementary Shareowners' Equity Information

	Net Foreign Currency Translation	Net Revaluation of Certain Financial Instruments	Net Minimum Pension Liability	Accumulated Other Comprehensive Income (Loss)
	(Dollars in millions)			
Accumulated other comprehensive income (loss):				
Balance at January 1, 2002	$(151)	$(159)	$ (32)	$(342)
Broadband spin	—	(20)	28	8
Change	132	319	(185)	266
Balance at December 31, 2002	(19)	140	(189)	(68)
Change	219	(115)	113	217
Balance at December 31, 2003	$ 200	$ 25	$ (76)	$ 149

	For the Years Ended December 31,		
	2003	2002	2001
	(Dollars in millions)		
Other comprehensive income (loss):			
Net foreign currency translation adjustment [net of taxes of $(136), $(82) and $160][(1)]	$ 219	$ 132	$ (250)
Net revaluation of certain financial instruments:			
Unrealized gains (losses) [net of taxes of $(45), $340, and $(343)][(2)]	72	(550)	475
Recognition of previously unrealized (gains) losses on available-for-sale securities [net of taxes of $116, $(539) and $(950)][(3)]	(187)	869	1,535
Net minimum pension liability adjustment [net of taxes of $(69), $112 and $14]	113	(185)	(18)
Total other comprehensive income	$ 217	$ 266	$1,742

(1) Includes LMG's foreign currency translation adjustments, net of taxes of $149 million from January 1, 2001 through July 31, 2001.

(2) Includes LMG's unrealized gains (losses) on available-for-sale securities, net of taxes of $(1,286) million from January 1, 2001 through July 31, 2001.

(3) See below for a summary of recognition of previously unrealized (gains) losses on available-for-sale securities.

	For the Years Ended December 31,					
	2003		2002		2001	
	Pretax	After Taxes	Pretax	After Taxes	Pretax	After Taxes
			(Dollars in millions)			
Summary of Recognition of Previously Unrealized (Gains) Losses on Available-for-Sale Securities:						
AT&T Group:						
Other income/expense, net:						
Sale/exchange of various securities	$(203)	$(125)	$ —	$ —	$ (238)	$ (147)
Other financial instrument activity	(100)	(62)	28	17	—	—
Other-than-temporary investment impairments	—	—	148	91	475	293
Income from discontinued operations:						
Other-than-temporary investment impairments	—	—	1,232	761	510	315
Reclassification of securities to "trading" in conjunction with the adoption of SFAS No. 133[1]	—	—	—	—	1,154	713
Sales of various securities	—	—	—	—	555	343
Liberty Media Group:						
Earnings (losses) from Liberty Media Group:						
Sales of various securities	—	—	—	—	173	105
Cumulative effect of accounting change[1]	—	—	—	—	(144)	(87)
Total recognition of previously unrealized (gains) losses	$(303)	$(187)	$1,408	$869	$2,485	$1,535

[1] See note 3 for a detailed discussion.

Supplementary Cash Flows Information

	For the Years Ended December 31,		
	2003	2002	2001
	(Dollars in millions)		
Interest payments, net of capitalized interest of $35, $61 and $121	$ 1,258	$1,532	$1,537
Income tax (receipts) payments	$ (1,201)	$ (814)	$1,441

5. Earnings Per Common Share and Potential Common Share

During 2001, in addition to AT&T common stock, the AT&T Wireless Group and Liberty Media Group tracking stocks were outstanding. The tracking stocks represented an interest in the economic performance of the net assets of each of the respective groups. The earnings attributable to AT&T Wireless Group and Liberty Media Group were excluded from the earnings attributable to the AT&T Common Stock Group. On July 9 and August 10, 2001, AT&T Wireless and Liberty Media Group, respectively, were separated from AT&T and the tracking stocks were redeemed (see note 2).

Income (loss) attributable to the different classes of AT&T common stock for the year ended December 31, 2001, is as follows:

	AT&T Common Stock Group	AT&T Wireless Group	Liberty Media Group	Total AT&T 2001
Income (loss) from continuing operations before cumulative effect of accounting change	$ 71	$—	$(2,711)	$(2,640)
Dividend requirements of preferred stock	(652)	—	—	(652)
Premium on exchange of AT&T Wireless tracking stock	(80)	—	—	(80)
Income (loss) from continuing operations attributable to common shareowners	(661)	—	(2,711)	(3,372)
(Loss) income from discontinued operations	(4,087)	35	—	(4,052)
Gain on disposition of discontinued operations	13,503	—	—	13,503
Cumulative effect of accounting change	359	—	545	904
Net income (loss) attributable to common shareowners	$ 9,114	$35	$(2,166)	$ 6,983

AT&T Common Stock Group

Basic earnings per common share (EPS) is computed by dividing income attributable to common shareowners by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution (considering the combined income and share impact) that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The potential issuance of common stock is assumed to occur at the beginning of the year (or at the time of issuance if later), and the incremental shares are included using the treasury stock method. The proceeds utilized in applying the treasury stock method consist of the amount, if any, to be paid upon exercise, the amount of compensation cost attributed to future service not yet recognized, and any tax benefits credited to paid-in-capital related to the exercise. These proceeds are then assumed to be used by AT&T to purchase common stock at the average market price during the period. The incremental shares (difference between the shares assumed to be issued and the shares assumed to be purchased), to the extent they would have been dilutive, are included in the denominator of the diluted EPS calculation.

A reconciliation of the share components for AT&T Common Stock Group basic to diluted EPS calculations is as follows:

	For the Years Ended December 31,		
	2003[1]	2002[1]	2001[1][2]
	(Shares in millions)		
Weighted-average common shares	788	746	729
Effect of dilutive securities:			
Stock options and restricted stock units	1	1	—
Preferred stock of subsidiary	—	3	—
Convertible quarterly income preferred securities	—	16	—
Weighted-average common shares and potential common shares	789	766	729

(1) No adjustments were made to income for the computation of diluted EPS.

(2) As AT&T reported a loss from continuing operations for 2001, the effects of including incremental shares are antidilutive; therefore, both basic and diluted EPS reflect the same calculation.

Preferred Stock of Subsidiary

Pursuant to the AT&T Broadband and Comcast merger agreement, AT&T was required to redeem the outstanding TCI Pacific Communications, Inc. Class A Senior Cumulative Exchangeable Preferred Stock (TCI Pacific preferred stock) for AT&T common stock. All outstanding shares of TCI Pacific preferred stock were either exchanged or redeemed for AT&T common stock during 2001 and 2002 (see note 10). Dividends were included in net (loss) from discontinued operations for 2002 and 2001.

Convertible Quarterly Income Preferred Securities (Quarterly Preferred Securities)

On June 16, 1999, AT&T Finance Trust I, a wholly owned subsidiary of AT&T, completed the private sale of 100 million shares of 5.0% cumulative quarterly income preferred securities (quarterly preferred securities) to Microsoft. Such securities were convertible into AT&T common stock. However, in connection with the AT&T Broadband spin-off (see note 2), Comcast assumed the quarterly preferred securities and Microsoft agreed to convert these preferred securities into shares of Comcast common stock. Dividends were included in net (loss) from discontinued operations for 2002 and 2001.

AT&T Wireless Group

Basic EPS from discontinued operations for AT&T Wireless Group for 2001 through June 30, 2001, the deemed effective split-off date for accounting purposes, was computed by dividing income attributable to AT&T Wireless Group by the weighted-average number of shares outstanding of AT&T Wireless Group of 438 million.

Liberty Media Group

Basic loss earnings per share for LMG through July 31, 2001, the deemed effective split-off date for accounting purposes, was computed by dividing losses attributable to LMG by the weighted-average number of LMG shares outstanding of 2,582 million. Potentially dilutive securities, including fixed and nonvested performance awards and stock options, have not been factored into the dilutive calculations because past history indicated that these contracts were generally settled in cash.

6. Net Restructuring and Other Charges

Net restructuring and other charges of $201 million for the year ended December 31, 2003, primarily consisted of separation costs associated with our management realignment efforts (which included approximately $9 million of pension curtailment losses). The separations were involuntary and impacted approximately 2,000 managers, more than 90% of whom have exited the business as of December 31, 2003. These activities were partially offset by the net reversal of $17 million of excess vintage employee separation liabilities.

The following table displays the activity and balances of the restructuring reserve account:

	Type of Cost			
	Employee Separations	Facility Closings	Other	Total
	(Dollars in millions)			
Balance at January 1, 2001	$ 242	$174	$ 36	$ 452
Additions	474	166	12	652
Deductions	(230)	(36)	(29)	(295)
Balance at December 31, 2001	486	304	19	809
Additions	306	78	—	384
Deductions	(413)	(99)	(16)	(528)
Balance at December 31, 2002	379	283	3	665
Additions	208	—	—	208
Deductions	(431)	(78)	(1)	(510)
Balance at December 31, 2003	$ 156	$205	$ 2	$ 363

In addition to the new exit plans recorded during 2002, total additions for 2002 in the table above also includes $39 million facility closing reserves recorded by Concert in 2001 and transferred to AT&T as part of the unwind of that joint venture.

Deductions in 2003, 2002 and 2001, primarily reflect total cash payments of $455 million, $410 million and $249 million, respectively. These cash payments include cash termination benefits of $377 million, $328 million and $202 million, respectively, which were primarily funded through cash from operations. Deductions also included reversals of excess vintage reserves of $17 million, $109 million and $33 million in 2003, 2002 and 2001, respectively. Additionally, in 2003, 2002 and 2001, there were reserve transfers of $38 million, $9 million and $13 million, respectively, out of the restructuring liability to long-term liability accounts primarily as a result of exiting managers deferring severance payments and accelerated vesting of equity awards (mostly related to executives). Substantially all of the employee headcount reductions associated with the 2002 and 2003 business restructuring plans have occurred as of December 31, 2003.

In 2002, net restructuring and other charges were $1,437 million, which included a $1,029 million charge for the impairment of the net assets of our consolidated subsidiary, AT&T Latin America, a $204 million impairment charge related to certain Digital Subscriber Line (DSL) assets and net business restructuring charges of $204 million.

In December 2002, the AT&T Board of Directors approved a plan for AT&T to sell its approximate 95% voting stake in AT&T Latin America in its current condition. On December 31, 2002, we signed a non-binding term sheet for the sale of our shares within one year for a nominal amount. As a result of this action, we classified AT&T Latin America as an asset held for sale at fair market value in accordance with SFAS No. 144, and accordingly, recorded a $1,029 million asset impairment charge to write down AT&T Latin America's assets. Our investment in AT&T Latin America was not recorded as a discontinued operation as we did not eliminate the cash flows generated from providing telecommunications services in the respective countries of Latin America. This charge was recorded within our AT&T Business Services segment.

An impairment charge of $204 million was recorded relating to certain DSL assets (including internal-use software, licenses, and property, plant and equipment) that would not be utilized by AT&T as a result of changes to our "DSL build" strategy. Instead of building DSL capabilities in all geographic areas initially targeted, we signed an agreement with Covad Communications to offer DSL services over its network. As a result, the assets in these areas were impaired. This charge was recorded within our AT&T Consumer Services segment.

Net business restructuring charges of $204 million recorded in 2002 consisted of new exit plans totaling $377 million and reversals of liabilities associated with prior years' exit plans of $173 million. The new plans primarily consisted of $334 million for employee separation costs ($28 million of which was recorded as a pension liability associated with management employees to be separated in 2002 which was funded from the pension trust) and $39 million of facility closing reserves. These exit plans separated slightly more than 4,800 employees, approximately one-half of whom were management employees and one-half were non-management employees. The majority of these employee separations were involuntary.

The $173 million reversal primarily consisted of $124 million of employee separation costs (approximately $48 million of which was reversed from the pension liability) and $26 million related to prior plan facility closings that were deemed to be no longer necessary. The reversals were primarily due to management's determination that the restructuring plan established in the fourth quarter of 2001 for certain areas of AT&T Business Services, including network services, needed to be modified given industry conditions at that time, as well as the redeployment of certain employees to different functions.

During 2001, net restructuring and other charges of $1,036 million were primarily comprised of $862 million for employee separations, of which $388 million related to benefits to be paid from pension assets, as well as pension and postretirement curtailment losses, and $166 million for facility closings. These charges were slightly offset by the reversal of $33 million related to business restructuring plans announced in the fourth quarter of 1999 and the first quarter of 2000 (of which $15 million related to employee separations and $18 million related to contract terminations).

The charge covered separation costs for approximately 10,000 employees, approximately one-half of whom were management employees and one-half were non-management employees. More than 9,000 employee separations related to involuntary terminations and the remaining 1,000 were voluntary.

7. Investments

Equity Method Investments

We have investments in various companies and partnerships that are accounted for under the equity method of accounting and included within other assets. Under the equity method, investments are stated at initial cost, and are adjusted for subsequent contributions and our share of earnings, losses and distributions as well as declines in value that are "other than temporary." At December 31, 2003 and 2002, we had equity investments included within other assets of $128 million and $135 million, respectively. Distributions from equity investments totaled $14 million, $5 million and $25 million for the years ended December 31, 2003, 2002 and 2001, respectively.

Summarized combined financial information for investments accounted for under the equity method that were significant to AT&T's financial results in 2001 is as follows:

	AT&T Canada(1)		Concert(2)	Other Equity Investments(3)
	For the Years Ended December 31,			
	2002	2001	2001	2001
	(Dollars in millions)			
Revenue	$ 947	$1,000	$ 6,189	$3,813
Operating (loss) income	(853)	(226)	(3,574)	86
(Loss) from continuing operations before extraordinary items and cumulative effect of accounting changes	(1,247)	(521)	(3,609)	(18)
Net (loss)	$(2,220)	$ (518)	$(3,609)	$ (20)

	At December 31, 2002
	(Dollars in millions)
Current assets	$ 386
Non-current assets	496
Current liabilities	3,152
Non-current liabilities	41

(1) The remaining interest in AT&T Canada was disposed of in February 2003; therefore, financial information for 2003 is not applicable.

(2) The Concert joint venture was unwound in April 2002; therefore, financial information for 2002 and 2003 is not applicable.

(3) In 2002 and 2003, equity investments were not significant to our financial results either individually or on a combined basis.

Concert

On April 1, 2002, Concert, our 50% owned joint venture with British Telecommunications plc (BT), was officially unwound and the venture's assets and customer accounts were distributed back to the parent companies, as agreed to in 2001. Under the partnership termination agreement, each of the partners generally reclaimed the customer contracts and assets that were initially contributed to the joint venture, including international transport facilities and gateway assets. In addition, AT&T assumed certain other assets that BT originally contributed to the joint venture.

In 2001, the agreement to dissolve the Concert venture impacted our intent and ability to hold our investment in Concert; therefore, we recorded a $1.8 billion after-tax impairment charge ($2.9 billion pretax) included in net (losses) related to other equity investments. The charge related to the difference between the fair market value of the net assets AT&T was to receive in the transaction and the carrying value of AT&T's investment in Concert. Certain items reserved for in 2001 were favorably settled, resulting in after-tax reversals of $59 million and $60 million in 2003 and 2002, respectively, which were recorded within net (losses) related to other equity investments.

AT&T Canada

AT&T had an approximate 31% ownership interest in AT&T Canada. Pursuant to a 1999 merger agreement, AT&T had a commitment to purchase, or arrange for another entity to purchase, the publicly owned shares of AT&T Canada for the greater of a contractual floor price or the fair market value (the Back-end Price). The floor price accreted 4% each quarter, commencing on June 30, 2000.

In 2002 and 2001, AT&T recorded charges reflecting the estimated loss on this commitment. The charges represented the difference between the fair value of the underlying publicly owned shares of AT&T Canada and the price AT&T had committed to pay for them, including the 4% accretion of the floor price. After-tax charges of $0.3 billion ($0.5 billion pretax) and $1.8 billion ($3.0 billion pretax) were recorded within net (losses) related to other equity investments for 2002 and 2001, respectively.

During 2002, AT&T arranged for third parties (Tricap Investment Corporation and CIBC Capital Partners) to purchase the remaining 69% equity in AT&T Canada. As part of this agreement, AT&T agreed to fund the purchase price on behalf of the third parties. Tricap and CIBC Partners made a nominal payment to AT&T upon completion of the purchase in October 2002. Although AT&T held an equity interest in AT&T Canada throughout 2002, we did not record equity earnings or losses since our investment balance was written down to zero largely through losses generated by AT&T Canada. In February 2003, we disposed of all of our AT&T Canada shares.

Alestra S. de R.L. de C.V.

We own a 49% economic interest in Alestra S. de R.L. de C.V. (Alestra), a telecommunications company in Mexico. During 2001, we stopped recording equity losses in Alestra due to the fact that we had no commitment to fund Alestra or to provide any other financial support. During 2002, Alestra experienced financial difficulties and sought to restructure its existing indebtedness to reduce the outstanding aggregate amount of the notes, to lower interest payments and extend the maturity on the notes. In 2003, Alestra completed the debt restructuring and AT&T and the other shareholders agreed to provide additional funding to Alestra. As a result, we funded $49 million to Alestra. In accordance with Emerging Issues Task Force issue 02-18, "Accounting for Subsequent Investments in an Investee after Suspension of Equity Method Loss Recognition," we recognized suspended losses in Alestra of $29 million during 2003.

Impairments — Equity Investments

Declines in value of equity method investments judged to be other than temporary are recorded in net (losses) related to other equity investments. In 2002 and 2001, we recorded impairment charges on equity method investments of $0.3 billion after taxes ($0.5 billion pretax), and $4.3 billion after taxes ($7.0 billion pretax), respectively. There were no material impairment charges recorded on equity method investments in 2003.

The 2002 charges primarily related to AT&T Canada and the 2001 charges primarily related to AT&T Canada and Concert, as discussed above. In addition, in 2001, we recorded an impairment charge on our investment in Net2Phone, Inc. (Net2Phone) of $0.7 billion after taxes ($1.1 billion pretax). This charge resulted from the deterioration of market valuations of Internet-related companies. In October 2001, we contributed our investment in Net2Phone to NTOP Holdings, LLC (NTOP), and received a 10% ownership interest in NTOP, which was subsequently sold in December 2002.

Cost Method Investments

At December 31, 2003 and 2002, we had cost method investments included in other assets of $57 million and $581 million, respectively. Approximately $0.5 billion of these investments at December 31, 2002, were indexed to certain long-term debt instruments, which were subsequently redeemed in February 2003 (see note 8). Under the cost method, earnings are recognized only to the extent distributions are received from the accumulated earnings of the investee. Distributions received in excess of accumulated earnings are recognized as a reduction of our investment balance. Cost investments are classified as available-for-sale and are reported at fair value, with unrealized gains and losses, net of taxes, recorded as a separate component of other comprehensive income (loss) in shareowners' equity. As of December 31, 2003, there were no unrealized holding losses recorded.

Impairments — Cost Method Investments

Declines in value of available-for-sale securities, judged to be other-than-temporary, are recorded in other income (expense), net. During 2002 and 2001, we believed that we would not recover our cost basis on certain investments in the foreseeable future given the significant decline in stock prices, the length of time these investments had been below market, and industry specific issues. Accordingly, we believed the declines in value were other-than-temporary and, as a result, recorded investment impairment charges on such securities of $0.1 billion after taxes ($0.1 billion pretax) and $0.3 billion after taxes ($0.5 billion pretax) for 2002 and 2001, respectively. The 2002 and 2001 impairments primarily consisted of charges related to Time Warner Telecom, which was the result of significant changes in the general business climate, as evidenced by the severe downward movement in the U.S. stock market, including the decline in the value of publicly-traded industry stocks. Our investment in Time Warner Telecom was subsequently sold in 2003. In addition, during 2002, we recorded a pretax impairment charge of $0.6 billion related to our holdings in AT&T Wireless, which was monetized by debt indexed to the value of the AT&T Wireless shares (see note 8). The debt contained an embedded derivative that was designated as a cash flow hedge. At the time, we recognized the other-than-temporary decline in the value of AT&T Wireless as an expense, and, as permitted by SFAS No. 133, we also recognized, in earnings, the previously unrecognized gain on the embedded derivative of $0.6 billion pretax, resulting in no net income impact. There were no material impairment charges recorded on cost method investments in 2003.

AT&T Wireless Group

On July 9, 2001, AT&T completed the split-off of AT&T Wireless (see note 2). At that time, AT&T retained an approximate 7.3% interest in AT&T Wireless common stock. In 2001, we recorded a $0.5 billion tax-free gain associated with the disposal of a portion of this ownership interest in a debt-for-equity exchange in other income (expense), net.

In February 2003, AT&T redeemed exchangeable notes that were indexed to AT&T Wireless common stock. The notes were settled with 78.6 million shares of AT&T Wireless common stock and $152 million in cash (see note 8). Also in February, AT&T sold its remaining investment in AT&T Wireless (approximately 12.2 million shares) for $72 million, resulting in a gain of $22 million recorded in other income (expense), net.

Japan Telecom Co. Ltd.

On April 27, 2001, AT&T completed the sale of its 10% stake in Japan Telecom Co. Ltd. to Vodafone for $1.35 billion in cash. The proceeds from the transaction were split evenly between AT&T and AT&T Wireless Group since AT&T Wireless Group held approximately one-half of AT&T's investment. The transaction resulted in a pretax gain of approximately $0.5 billion recorded in other income (expense), net and a pretax gain of approximately $0.5 billion recorded in net (loss) from discontinued operations.

8. Debt Obligations

Debt Maturing within One Year

	At December 31, 2003	At December 31, 2002
	(Dollars in millions)	
Commercial paper	$ 753	$1,091
Short-term notes	150	1,086
Currently maturing long-term debt	436	1,581
Other	4	4
Total debt maturing within one year	$1,343	$3,762
Weighted-average interest rate of short-term debt[1]	1.3%	3.4%

[1] Excludes currently maturing long-term debt.

Securitizations

During 2003, we renewed our AT&T Consumer Services customer accounts receivable securitization facility and entered into a new AT&T Business Services customer accounts receivable securitization facility, both of which extend through July 2004. Under the program, accounts receivable are sold on a discounted, revolving basis, to special-purpose, wholly-owned and fully consolidated subsidiaries of AT&T, which assign interests in such receivables to unrelated third-party financing entities. Together, the programs provided $1.65 billion of available financing at December 31, 2003, limited by the eligible receivables balance, which varies from month to month. In March 2004, AT&T reduced the combined facility size to $1.45 billion, limited by the eligible receivables balance. The facilities require AT&T to meet a debt-to-EBITDA ratio (as defined in the agreements) not exceeding 2.25 to 1. At December 31, 2003, we were in compliance with this covenant. At December 31, 2003, the available financing was collateralized by $3.0 billion of accounts receivable. Approximately $150 million was outstanding at December 31, 2003 and 2002, and was included in short-term notes in the table above.

Credit Facility

At December 31, 2003, we had a $2.0 billion syndicated 364-day credit facility available to us that was entered into October 8, 2003. The credit facility contains an option to extend the term of the agreement for an additional 364-day period beyond October 7, 2004. Up to $300 million of the facility can be utilized for letters of credit, which reduces the amount available. At December 31, 2003, approximately $118 million of letters of credit were outstanding under the facility. Additionally, the credit facility contains a financial covenant that requires AT&T to meet a debt-to-EBITDA ratio (as defined in the credit agreement) not exceeding 2.25 to 1 and an EBITDA-to-net interest expense ratio (as defined in the credit agreement) of at least 3.50 to 1 for four consecutive quarters ending on the last day of each fiscal quarter. At December 31, 2003, we were in compliance with these covenants.

Pursuant to the definitions in the credit facility and securitization facilities, business restructuring and asset impairment charges have no impact on the EBITDA financial covenants.

Long-Term Debt

Debentures and Notes		At December 31, 2003[1]	At December 31, 2002[1]
Interest Rates[2]	Maturities	(Dollars in millions)	
5.63% – 6.00%	2009	$ 1,028	$ 1,455
6.38% – 6.50%	2013 – 2029	411	6,678
6.75% – 7.50%	2004 – 2006	4,958	2,449
7.75% – 8.85%	2004 – 2031	6,043	6,796
9.90% – 10.00%	2004	10	13
Variable rate	2005 – 2054	980	3,012
Total debentures and notes		13,430	20,403
Other		97	105
Unamortized discount, net		(25)	(115)
Total long-term debt		13,502	20,393
Less: currently maturing long-term debt		436	1,581
Net long-term debt		$13,066	$18,812

(1) Debt amounts are included within the range of interest rates that are applied at each respective balance sheet date. See below for a discussion of interest rate changes that occurred during 2003.

(2) The actual interest paid on our debt obligations may have differed from the stated amount due to our entering into interest rate swap contracts to manage our exposure to interest rate risk and our strategy to reduce finance costs (see note 9).

The following table shows maturities at December 31, 2003, of the $13.5 billion in total long-term obligations:

2004	2005	2006	2007	2008	Later Years
(Dollars in millions)					
$436	$1,204	$4,326	$297	$4	$7,235

On January 31, 2003, AT&T completed the early retirement of $1,152 million and $2,590 million long-term notes, with interest rates of 6.375% and 6.50%, due in March 2004 and March 2013, respectively. The notes were repurchased with cash and resulted in a loss of $178 million recorded in other income (expense), net.

On September 15, 2003, AT&T completed the early retirement of $322 million and $184 million long-term notes, both with interest rates of 8.125%, due in January 2022 and July 2024, respectively. The notes were repurchased with cash and resulted in a loss of $23 million recorded in other income (expense), net.

On October 22, 2003, AT&T completed the early retirement of three long-term notes totaling approximately $1.1 billion. The first note of $236 million, had an interest rate of 8.625%, and was due in December 2031. The other two notes, with $410 million and $439 million of principal amounts outstanding, bore interest rates of 5.625% and 6.375%, respectively, and were each due in March 2004. The notes were repurchased with cash and resulted in a loss of $32 million recorded in other income (expense), net.

Also in 2003, we exercised our purchase option on buildings we had leased, which were consolidated in July along with debt of approximately $477 million, as a result of our adoption of FIN No. 46 (see note 3). A $28 million loss on the early extinguishment of debt was recorded in other income (expense), net.

As a result of a long-term credit rating downgrade by Standard & Poor's in July 2003, the interest rate on approximately $10 billion in notional amount of debt, $1.3 billion of which matured in November 2003, increased by 25 basis points.

The holders of certain private debt with an outstanding balance of $1.0 billion at December 31, 2003, have an annual put right to cause AT&T to repay the debt upon payment of an exercise fee. In exchange for the debt holders agreeing to not exercise their put right, in 2004, AT&T renewed a cash-collateralized letter of credit, totaling $0.5 billion now expiring in March 2005. The $0.5 billion is considered restricted cash and is included in other assets at December 31, 2003. The debt holders could accelerate repayment of the debt based on certain events such as the occurrence of unfavorable local law or regulation changes in its country of operation.

In February 2004, we offered to repurchase, for cash, any and all of our $1.5 billion outstanding 6.5% Notes maturing in November 2006, which now carry an interest rate of 7.25%. The offer to early redeem these securities expired on March 3, 2004, with $1.2 billion of notes redeemed, which will result in a loss of approximately $150 million in the first quarter of 2004. Also, we offered to repurchase for cash up to € 1 billion of our outstanding € 2 billion 6.0% Notes due November 2006, which now carry an interest rate of 6.75%. This repurchase is expected to close by the end of March 2004.

Exchangeable Notes

At December 31, 2002, we had long-term debt (exchangeable notes) with a carrying value of $519 million that was indexed to 90.8 million shares of AT&T Wireless common stock and, at AT&T's option, was mandatorily redeemable with a number of shares of AT&T Wireless common stock that was equal to the underlying shares multiplied by an exchange ratio, or its cash equivalent. The notes were accounted for as indexed debt instruments, because the carrying value of the debt was dependent upon the fair market value of the underlying securities. In addition, the notes contained embedded derivatives, which were designated as cash flow hedges that required separate accounting. The options hedged the market risk of a decline in value of AT&T Wireless securities. These designated options were carried at fair value with changes in fair value recorded, net of income taxes, within accumulated other comprehensive income (loss), as a component of shareowners' equity.

In February 2003, AT&T redeemed these exchangeable notes with 78.6 million shares of AT&T Wireless common stock and $152 million in cash. The settlement resulted in a pretax gain of approximately $176 million recorded in other income (expense), net. Also in February 2003, the 12.2 million remaining AT&T Wireless shares were subsequently sold (see note 7).

9. Financial Instruments

In the normal course of business, we use various financial instruments, including derivative financial instruments, to manage our market risk from changes in interest rates, foreign exchange rates and equity prices associated with previously affiliated companies, as well as to manage our risk resulting from fluctuations in prices of securities. We do not use financial instruments for trading or speculative purposes. Our financial instruments include letters of credit, guarantees of debt and certain obligations of former affiliates, interest rate swap agreements, foreign currency exchange contracts, option contracts, equity contracts and warrants. AT&T is generally not required to post collateral for these types of instruments, except for certain letters of credit. However, as the requirements for collateral are generally dependent upon debt ratings and market conditions, AT&T may be required to post collateral for interest rate and equity swaps, as well as letters of credit in the future.

By their nature, all such instruments involve exposure to credit risk and market risk. Credit risk is the risk of nonperformance by counter-parties under the terms of the contract. We control our exposure to credit risk through credit approvals, credit limits and monitoring procedures. Our maximum potential loss may exceed the amount recognized in our balance sheet. However, at December 31, 2003 and 2002, in management's opinion, there was no significant risk of loss in the event of nonperformance of the counter-parties to these financial instruments. Market risk is the risk that the value of the instrument may be adversely affected by changes in interest rates, currency exchange rates, or equity prices. We continually manage this risk through monitoring procedures, which limit the type and amount of exposure to these risks. Other than the guarantee issued in connection with the split-off of AT&T Wireless, we do not have any significant exposure to any individual customer or counter-party, nor do we have any major concentration of credit risk related to any financial instruments.

Letters of Credit

Letters of credit are purchased guarantees that ensure our performance or payment to third parties in accordance with specified terms and conditions. Management has determined that our letters of credit do not create additional risk to AT&T.

The notional amounts outstanding at December 31, 2003 and 2002, were $1.1 billion and $0.9 billion, respectively. The letters of credit in effect at December 31, 2003, were collateralized by restricted cash of $499 million, which was recorded within other assets. The letters of credit in effect as of December 31, 2002 were collateralized by restricted cash of $496 million, of which $442 million was recorded in other assets and $54 million was recorded in other current assets. The fair values of the letters of credit, based on the fees paid to obtain the obligations, were immaterial at December 31, 2003 and 2002.

Guarantees

In connection with the separation of certain subsidiaries, we issued guarantees for certain debt and other obligations of our former subsidiaries NCR, AT&T Wireless and AT&T Broadband.

Total notional amounts of guaranteed debt at December 31, 2003 and 2002, were $6 million and $506 million, respectively. Prior to the spin-off of AT&T Broadband, we had guaranteed certain debt of AT&T Broadband that matured in 2038, which remained outstanding after the spin-off of AT&T Broadband. In the fourth quarter of 2003, Comcast called this debt, which relieved AT&T of a $500 million commitment. The remaining guarantees for debt, which relate to NCR, have expiration dates ranging from 2004 to 2020. Should the financial condition of NCR deteriorate to the point at which it is unable to meet its obligations, third party creditors could look to us for payment. We currently hold no collateral for this guarantee, and have not recorded a corresponding obligation. At December 31, 2003 and 2002, there were no quoted market prices for similar agreements.

AT&T provides a guarantee of an obligation that AT&T Wireless has to NTT DoCoMo. The amounts of the guarantee at December 31, 2003 and 2002, were $4.4 billion and $4.1 billion, respectively. On January 21, 2001, NTT DoCoMo invested approximately $9.8 billion for shares of AT&T preferred stock that were converted into AT&T Wireless common stock in connection with the split-off of AT&T Wireless. Of the initial investment, AT&T retained approximately $3.6 billion, with the remainder of the proceeds allocated to AT&T Wireless. In connection with that investment, AT&T and AT&T Wireless agreed that, under certain circumstances, including if AT&T Wireless fails to meet specific technological milestones by June 30, 2004, NTT DoCoMo would have the right to require AT&T Wireless to repurchase its AT&T Wireless common stock for $9.8 billion, plus interest. In the event AT&T Wireless is unable to satisfy the entire obligation, AT&T is secondarily liable for up to $3.65 billion, plus accrued interest. On December 26, 2002, AT&T Wireless and NTT DoCoMo entered into an amendment to the original agreement, which, among other things, extended the deadline for compliance with the technological milestones to December 31, 2004. AT&T's guarantee expires on June 30, 2004, in accordance with the terms of the original agreement. We currently hold no collateral for this guarantee, and have not recorded a corresponding obligation. At December 31, 2003 and 2002, there were no quoted market prices for similar agreements.

The total notional amount of other guaranteed obligations at December 31, 2003 and 2002 was $224 million and $458 million, respectively. Prior to the spin-off of AT&T Broadband, we guaranteed various obligations of AT&T Broadband. In connection with the spin-off of AT&T Broadband, we continue to provide guarantees of these obligations, including operating leases for real estate, surety bonds, and equity hedges. These guarantees have expiration dates ranging from 2004 through 2007. Comcast has provided full indemnification for these guarantees as of December 31, 2003. Should the financial condition of Comcast deteriorate to the point at which they are unable to meet their obligations, third party creditors could look to us for payment. We currently hold no collateral for these guarantees, and have not recorded corresponding obligations. At December 31, 2003, there were no quoted market prices for similar agreements.

Interest Rate Swap Agreements

We enter into interest rate swaps to manage our exposure to changes in interest rates. We enter into swap agreements to manage the fixed/floating mix of our debt portfolio in order to reduce aggregate risk of interest rate movements. Interest rate swaps allow us to raise funds at floating rates and effectively swap them into fixed rates that are generally lower than those available to us if fixed rate borrowings were made directly, or to swap fixed-rate borrowings to floating rates when interest rates are expected to stay low. These agreements involve the exchange of floating-rate for fixed-rate payments or the exchange of fixed-rate for floating-rate payments without the exchange of the underlying notional amount. Floating-rate payments and receipts are primarily tied to the LIBOR (London Inter-Bank Offered Rate). In 2003, we entered into $1.0 billion notional amount of fixed-to-floating interest rate swaps, which we designated as fair value hedges in accordance with SFAS No. 133, as amended. The floating-rate to fixed-rate swaps were designated as cash flow hedges as of December 31, 2003. There was no ineffectiveness recognized in earnings for our fair value or cash flow hedges during 2003 and 2002.

The following table indicates the types of swaps in use at December 31, 2003 and 2002, the respective notional amounts and their weighted-average interest rates. Average floating rates are those in effect at the reporting date, and may change significantly over the lives of the contracts.

	At December 31,	
	2003	2002
	(Dollars in millions)	
Fixed-rate to floating-rate swaps — notional amount	$1,000	$ —
Weighted-average receipt rate	4.23%	—
Weighted-average pay rate	2.67%	—
Floating-rate to fixed-rate swaps — notional amount	$ 190	$190
Weighted-average receipt rate	1.38%	1.81%
Weighted-average pay rate	7.30%	7.30%

In connection with debt redeemed in the first quarter of 2004 (see note 8), we unwound $250 million notional amount of fixed-to-floating interest rate swaps.

In addition, we have combined interest rate foreign currency swap agreements for foreign-currency-denominated debt, which hedge our risk to both interest rate and currency movements, $1.8 billion of which are designated as cash flow hedges for accounting purposes in 2003 and 2002. There was no ineffectiveness recognized in earnings for these hedges during 2003 and 2002. At December 31, 2003 and 2002, the notional amounts related to these contracts were $2.5 billion and $3.8 billion, respectively. The decrease in the notional amounts primarily related to the $1.3 billion Euro bonds contract, which matured in the fourth quarter of 2003.

In connection with the combined interest rate swap agreements, as of December 31, 2003, we had received $232 million of cash collateral (included in cash).

The table below summarizes the fair and carrying values of the agreements. These swaps are valued using current market quotes, which were obtained from dealers.

	At December 31,			
	2003		2002	
	Carrying/Fair Value		Carrying/Fair Value	
	Asset	Liability	Asset	Liability
	(Dollars in millions)			
Interest rate swap agreements	$ —	$41	$ —	$23
Combined interest rate foreign currency swap agreements	1,002	—	660	—

Foreign Exchange

We enter into foreign currency forward contracts to manage our exposure to changes in currency exchange rates related to foreign-currency-denominated transactions. Although we do not designate most of our foreign exchange contracts as accounting hedges, we have certain contracts that are designated as foreign currency cash flow hedges in accordance with SFAS No. 133. At December 31, 2003, our foreign exchange contracts consisted principally of Euros, British pound sterling, Danish krone and Swiss francs. At December 31, 2002, our foreign exchange contracts consisted principally of Euros, Japanese yen, and Swiss francs. In addition, we are subject to foreign exchange risk related to other foreign-currency-denominated transactions. The notional amounts under contract at December 31, 2003 and 2002, were $1.1 billion and $742 million, respectively, $45 million and $44 million of which were designated as cash flow hedges, respectively. There was no ineffectiveness recognized in earnings for these hedges during 2003 and 2002. The following table summarizes the carrying and fair values of the foreign exchange contracts at December 31, 2003 and 2002. These foreign exchange contracts are valued using current market quotes which were obtained from independent sources.

	At December 31,			
	2003		2002	
	Carrying/Fair Value		Carrying/Fair Value	
	Asset	Liability	Asset	Liability
	(Dollars in millions)			
Foreign exchange contracts	$ 87	$14	$ 41	$ 2

Equity Option and Equity Swap Contracts

We enter into equity option and equity swap contracts, which are undesignated, to manage our exposure to changes in equity prices associated with various equity awards of previously affiliated companies (see note 12). The notional amounts outstanding on these contracts at December 31, 2003 and 2002 were $91 million and $112 million, respectively. The following table summarizes the carrying and fair values of these instruments at December 31, 2003 and 2002. Fair values are based on market quotes.

	At December 31,			
	2003		2002	
	Carrying/Fair Value		Carrying/Fair Value	
	Asset	Liability	Asset	Liability
	(Dollars in millions)			
Equity hedges	$ 5	$12	$ —	$25

Warrants

We may obtain warrants to purchase equity securities in private and public companies as a result of certain transactions. Private warrants and public warrants that provide for net share settlement (i.e. allow for cashless exercise) are considered to be derivative instruments and recognized on our balance sheet at fair value (in accordance with SFAS No. 133, as amended). Warrants are not eligible to be designated as hedging instruments because there is no underlying exposure. Instead, these are effectively investments in private and public companies. The carrying and fair value of these warrants was not material at December 31, 2003 and 2002.

Debt Securities

The carrying value of debt with an original maturity of less than one year approximates market value. The table below summarizes the carrying and fair values of long-term debt (including currently maturing long-term debt), excluding capital leases, at December 31, 2003 and 2002. The fair values of long-term debt were obtained based on quotes or rates available to us for debt with similar terms and maturities.

	At December 31,			
	2003		2002	
	Carrying/Fair Value		Carrying/Fair Value	
	Asset	Liability	Asset	Liability
	(Dollars in millions)			
Long-term debt, excluding capital leases	$13,406	$14,820	$20,292	$21,030

Derivative Impacts

The following table summarizes the activity in accumulated other comprehensive income (loss) in shareowners' equity related to derivatives designated as cash flow hedges during the periods January 1, 2002 through December 31, 2003.

	Pretax	After taxes
	(Dollars in millions)	
Balance at January 1, 2002	$ (395)	$ (244)
Unrealized gains (losses)	1,420	876
Realized (gains) losses reclassified into earnings	(1,259)	(777)
Net amounts spun-off with AT&T Broadband	317	196
Balance at December 31, 2002	83	51
Unrealized gains (losses)	39	25
Realized (gains) losses reclassified into earnings	(100)	(62)
Balance at December 31, 2003	$ 22	$ 14

Included within the balance at December 31, 2002, were unrealized gains of $131 million pretax ($81 million after taxes) on embedded derivatives related to exchangeable notes that were indexed to AT&T Wireless common stock, which were settled in February 2003.

In connection with the planned redemption of a portion of our Euro Bonds maturing in 2006, and the unwind of related cash flow hedges, we expect to recognize, in the first quarter of 2004, unrealized gains currently recorded in accumulated other comprehensive income (loss) (see note 18). The impact of this transaction will vary based on the market and other conditions at the time of redemption and cannot be currently estimated.

10. Equity Transactions

In June 2002, AT&T completed a public equity offering of 46 million shares of AT&T common stock for net proceeds of $2.5 billion. We utilized the proceeds from the offering to satisfy a portion of our obligation to AT&T Canada common shareholders (see note 7).

Pursuant to the AT&T Broadband and Comcast merger agreement (see note 2), AT&T was required to redeem the outstanding TCI Pacific Communications, Inc. Class A Senior Cumulative Exchangeable Preferred Stock for AT&T common stock. Each share of TCI Pacific preferred stock was exchangeable, at the option of the holder, for 1.673 shares of AT&T common stock. During 2002, all outstanding shares (approximately 6.2 million) of TCI Pacific preferred stock were either exchanged or redeemed for approximately 10.4 million shares of AT&T common stock. No gain or loss was recorded on the exchange/redemption of the TCI Pacific preferred stock.

During 2002, AT&T issued 2.9 million shares of AT&T common stock to certain current and former senior managers in settlement of their deferred compensation accounts. Pursuant to AT&T's deferred compensation plan, senior managers may defer short- and long-term incentive compensation awards. The issuance of these shares resulted in an increase to total shareowners' equity of $196 million.

On January 22, 2001, NTT DoCoMo invested approximately $9.8 billion for 812,512 shares of a new class of AT&T preferred stock with a par value of $1 per share. On July 9, 2001, in conjunction with the split-off of AT&T Wireless Group (see note 2), these preferred shares were converted into AT&T Wireless common stock. During 2001, we recorded dividend requirements on this preferred stock of $652 million. The preferred stock dividend represented interest in connection with the NTT DoCoMo preferred stock, as well as accretion of the beneficial conversion feature associated with this preferred stock. The beneficial conversion feature was recorded upon the issuance of the preferred stock and represented the excess of the fair value of the preferred shares issued over the proceeds received.

11. Pension, Postretirement and Other Employee Benefit Plans

We sponsor noncontributory defined benefit pension plans covering the majority of our U.S. employees. Pension benefits for management employees are principally based on career-average pay. Pension benefits for occupational employees are not directly related to pay. Pension trust contributions are made to trust funds held for the sole benefit of plan participants. Our benefit plans for current and certain future retirees include health-care benefits, life insurance coverage and telephone concessions. We use a December 31 measurement date for the majority of our plans.

U.S. Plans

The following table shows the components of net periodic benefit (credit) costs for continuing operations:

	Pension Benefits			Postretirement Benefits		
	For the Years Ended December 31,					
	2003	2002	2001	2003	2002	2001
	(Dollars in millions)					
Service cost — benefits earned during the period	$ 223	$ 209	$ 226	$ 24	$ 23	$ 26
Interest cost on benefit obligations	941	1,002	938	367	365	344
Amortization of unrecognized prior service cost	145	152	172	40	12	4
Credit for expected return on plan assets	(1,449)	(1,526)	(1,647)	(152)	(187)	(201)
Amortization of transition asset	—	(34)	(89)	—	—	—
Amortization of losses (gains)	4	(22)	(182)	81	5	—
Charges (credits) for special termination benefits*	—	(19)	188	14	—	28
Net curtailment losses*	9	—	113	—	—	59
Net settlement losses	10	6	4	—	—	—
Net periodic benefit (credit) cost	$ (117)	$ (232)	$ (277)	$ 374	$ 218	$ 260

* Primarily included in net restructuring and other charges.

In connection with our restructuring plan implemented during 2003, we recorded a $9 million pension curtailment loss associated with our management realignment efforts, as well as a $14 million charge related to expanded eligibility for postretirement benefits for certain employees that exited under the plan.

In connection with our restructuring plan announced in the fourth quarter of 2001, we recorded a $188 million charge related to management employee separation benefits that were funded by assets of the AT&T Management Pension Plan, as well as a $28 million charge related to expanded eligibility for postretirement benefits for certain employees that exited under the plan. We also recorded pension and postretirement benefit curtailment charges of $172 million.

The following tables provide a reconciliation of the changes in the plans' benefit obligations and fair value of assets, and a statement of the funded status:

	Pension Benefits		Postretirement Benefits	
	For the Years Ended December 31,			
	2003	2002	2003	2002
	(Dollars in millions)			
Change in benefit obligations:				
Benefit obligations, beginning of year	$14,985	$13,878	$ 5,839	$ 5,277
Service cost	223	209	24	23
Interest cost	941	1,002	367	365
Participants' contributions	—	—	42	9
Plan amendments	24	34	173	14
Actuarial losses	799	1,134	362	640
Benefit payments	(1,175)	(1,221)	(547)	(489)
Special termination (credits) benefits	—	(19)	14	—
Settlements	(29)	(32)	—	—
Curtailment gains	(1)	—	—	—
Benefit obligations, end of year	$15,767	$14,985	$ 6,274	$ 5,839
Change in fair value of plan assets:				
Fair value of plan assets, beginning of year	$15,603	$18,449	$ 1,745	$ 2,156
Actual return on plan assets	3,067	(1,663)	316	(255)
Employer contributions	89	70	501	324
Participants' contributions	—	—	42	9
Benefit payments	(1,175)	(1,221)	(547)	(489)
Settlements	(29)	(32)	—	—
Fair value of plan assets, end of year	$17,555	$15,603	$ 2,057	$ 1,745

	At December 31,			
	2003	2002	2003	2002
Funded (unfunded) benefit obligation	$ 1,788	$ 618	$(4,217)	$(4,094)
Unrecognized net loss	882	1,715	1,807	1,684
Unrecognized prior service cost (credits)	639	769	123	(10)
Net amount recorded	$ 3,309	$ 3,102	$(2,287)	$(2,420)

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was signed into law. The Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. We are impacted by the Act since we sponsor a postretirement health care plan that provides prescription drug benefits. We have elected to defer recognition of the Act in accordance with Financial Accounting Standards Board Staff Position No. FAS 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003." As a result, any measures of the accumulated postretirement benefit obligation or net periodic postretirement benefit cost do not reflect the effects of the Act on the plan. Specific authoritative guidance on accounting for the federal subsidy is pending and that guidance, when issued, could require us to change previously reported information.

The weighted-average asset allocation of the pension and postretirement plans by asset category and target range are as follows:

	Pension Plan Assets			Postretirement Plan Assets		
	At December 31,					
	2003	2002	Target Range	2003	2002	Target Range
Equity securities[1]	68%	63%	60-70%	61%	55%	60-75%
Debt securities	23%	27%	20-30%	23%	28%	23-35%
Real estate	9%	10%	5-15%	0%	0%	0%
Other[2]	0%	0%	0%	16%	17%	0-10%
Total	100%	100%		100%	100%	

(1) At December 31, 2003, and 2002, our pension plan assets included $7 million and $13 million of AT&T common stock, respectively.

(2) Other postretirement plan assets primarily consisted of cash and cash equivalents at December 31, 2003 and 2002. The target range is determined based on anticipated cash requirements to partially fund benefit payments. The year-end cash level was higher than the target range due to year-end cash contributions made to the postretirement welfare benefit plan. Prospectively, company contributions to the trust are expected to be made periodically throughout the year.

The assets of the pension and postretirement welfare benefit plans are managed with the objective of maximizing returns subject to prudent risk taking. We complete an asset-liability study at least once every two years (or more frequently, if necessary) for the pension plans and on an as necessary basis for postretirement welfare benefit plans, to ensure that the optimal asset allocation is maintained in order to meet future benefit obligations. We use derivative financial instruments including futures contracts, forward contracts, and options to enhance returns on the pension plan asset investments and to limit exposure to market fluctuations. The use of options is permitted for debt investments but is prohibited for public equity investments. It is not our policy to use these derivative financial instruments for speculative purposes.

The following table provides the amounts recorded in our consolidated balance sheets:

	Pension Benefits		Postretirement Benefits	
	At December 31,			
	2003	2002	2003	2002
	(Dollars in millions)			
Prepaid pension cost	$3,853	$ 3,596	$ —	$ —
Benefit related liabilities	(901)	(1,255)	(2,287)	(2,420)
Intangible asset (in other assets)	337	456	—	—
Accumulated other comprehensive income	20	305	—	—
Net amount recorded	$3,309	$ 3,102	$(2,287)	$(2,420)

Included in other comprehensive income was a pretax (decrease) increase in the minimum pension liability of $(285) million, $289 million, and $(6) million, for the years ended 2003, 2002 and 2001, respectively.

The accumulated benefit obligation for all defined benefit pension plans was $15.5 billion and $14.7 billion at December 31, 2003, and 2002, respectively. The following table provides information for pension plans with an accumulated benefit obligation in excess of plan assets:

	At December 31, 2003	At December 31, 2002
	(Dollars in millions)	
Projected benefit obligation	$10,340	$9,811
Accumulated benefit obligation	10,057	9,532
Fair value of plan assets	9,157	8,279

The following table reflects the weighted-average assumptions used to determine the benefit obligations and net periodic benefit cost for the pension and postretirement plans:

	Benefit Obligations		Net Periodic Benefit Cost		
	At December 31,		For the Years Ended December 31,		
	2003	2002	2003	2002	2001
Discount rate	6.00%	6.50%	6.50%	7.25%	7.50%
Rate of compensation increase	4.00%	4.25%	4.25%	5.90%	5.90%
Expected return on plan assets	—	—	8.50%	9.00%	9.50%

The assumptions in the above table were reassessed as of December 31, 2003. The discount rate was reduced to 6% based on current yields on high quality corporate fixed-income investments with maturities corresponding to the expected duration of the benefit obligations. Additionally, the rate of projected compensation increase was reduced to 4% reflecting expected inflation levels, our actual recent experience and future outlook. We conducted an expected long-term rate of return study on pension and postretirement benefit plan assets. This study consisted of forward-looking projections for a risk-free rate of return, inflation rate, and risk premiums for particular asset classes. Historical returns were not used. The results of this study were applied to the target asset allocation in accordance with our plan investment strategies. The expected long-term rate of return on plan assets was determined based on the weighted-average of projected returns on each asset class. As a result, the expected rate of return on plan assets will remain unchanged for 2004.

The following table provides the assumed health care cost trend rates for postretirement benefit plans:

	At December 31, 2003	At December 31, 2002
Health care cost trend rate assumed for next year	10.2%	10.9%
Rate to which the cost trend rate is assumed to decline (ultimate trend rate)	5.0%	5.0%
Year that the rate reaches the ultimate trend rate	2008	2010

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage point increase or decrease in the assumed health care cost trend rates would have the following effects:

	One-Percentage Point Increase	One-Percentage Point Decrease
	(Dollars in millions)	
Effect on total of service and interest cost	$ 11	$ (10)
Effect on accumulated postretirement benefit obligation	190	(166)

We expect to contribute approximately $30 million to the nonqualified pension plan in 2004. No contribution is expected for the qualified pension plans in 2004 or 2005. We also expect to contribute approximately $0.6 billion to the postretirement benefit plans in 2004.

We also sponsor savings plans for the majority of our U.S. employees. The plans allow employees to contribute a portion of their pretax and/or after-tax income in accordance with specified guidelines. We match a percentage of the employee contributions up to certain limits. Contributions to such U.S. saving plans relating to continuing operations amounted to $136 million in 2003, $135 million in 2002, and $131 million in 2001.

Non-U.S. Plans

Certain non-U.S. operations have varying types of retirement programs providing benefits for substantially all of their employees. The projected benefit obligations of the defined benefit pension plans were $634 million and $523 million at December 31, 2003 and 2002, respectively. The fair value of plan assets was $442 million and $324 million as of December 31, 2003 and 2002, respectively. The benefit obligations were determined using a weighted-average discount rate of 5.40% at December 31, 2003 and December 31, 2002, and a weighted-average rate of compensation increase of 3.90% and 3.95% as of December 31, 2003 and 2002, respectively.

Certain of these defined benefit plans had accumulated benefit obligations of $512 million at December 31, 2003, which were in excess of the fair value of plan assets of $386 million, resulting in total unfunded accumulated benefit obligations of $126 million as of December 31, 2003. As a result of the under-funded status of these plans, we recorded an additional minimum pension liability of $103 million as a charge to other comprehensive income (loss).

12. Stock-Based Compensation Plans

Under the 1997 Long-term Incentive Program (Program), which was effective June 1, 1997, and amended on May 19, 1999, and March 14, 2000, we grant stock options, performance shares, restricted stock and other awards in AT&T common stock, and also granted stock options on AT&T Wireless Group tracking stock prior to the split-off of AT&T Wireless. The Program expires on May 31, 2004.

Under the initial terms of the Program, there were 30 million shares of AT&T common stock available for grant with a maximum of 4.5 million common shares that could be used for awards other than stock options. Subsequent to the 1999 modification, beginning with January 1, 2000, the remaining shares available for grant at December 31 of the prior year, plus 1.75% of the shares of AT&T common stock outstanding on January 1 of each year, become available for grant. Under the amended terms, a maximum of 7.5 million shares may be used for awards other than stock options. As a result of the AT&T Wireless split-off in 2001, the number of shares available for grant increased by 3.5 million, which includes 0.6 million for awards other than stock options. In 2002, AT&T restructured stock options and other stock-based awards in conjunction with the AT&T Broadband spin-off. The number of shares available for grant increased by 44.5 million, which includes 0.8 million for awards other than stock options. The exercise price of any stock option is equal to the stock price when the option is granted. Generally, the options vest over three or four years and are exercisable up to 10 years from the date of grant.

Under the Program, performance share units (equivalent to one common share) are awarded to key employees in the form of either common stock or cash at the end of a three-year period, based on certain financial-performance targets.

On April 27, 2000, AT&T created a new class of stock and completed an offering of AT&T Wireless Group tracking stock. Under the Program, AT&T issued AT&T Wireless Group stock options to employees. The exercise price of any stock option was equal to the stock price when the option was granted. When granted, the options had a two to three and one-half year vesting period, and were exercisable up to 10 years from the date of grant. On April 27, 2000, substantially all employees were granted AT&T Wireless Group tracking stock options.

In connection with the July 9, 2001, split-off of AT&T Wireless Group, all outstanding AT&T Wireless Group tracking stock options and all AT&T common stock options granted prior to January 1, 2001, were converted in the same manner as common shares (see note 2). AT&T modified the terms and conditions of all outstanding stock option grants to allow the AT&T Wireless common stock options held by AT&T employees to immediately vest and become exercisable for their remaining contractual term and to also allow the AT&T common stock options held by AT&T Wireless employees to immediately vest and become exercisable for their remaining contractual term. In 2001, AT&T recognized $3 million of compensation expense related to these modifications.

In connection with the spin-off of AT&T Broadband, all outstanding AT&T stock options held by active AT&T employees were restructured into an adjusted number of AT&T options. All outstanding AT&T stock options held by active AT&T Broadband employees were restructured into an adjusted number of AT&T Broadband options and subsequently replaced with new Comcast stock options, and all AT&T stock options held by inactive employees at the time of the spin-off were converted into adjusted AT&T stock options and new Comcast stock options. In January 2002, AT&T modified the terms and conditions of outstanding AT&T stock options and other equity awards granted under plans other than the Program and held by AT&T Broadband employees. This modification provided that upon the change in control of AT&T Broadband, their stock options and other equity awards granted prior to December 19, 2001, would be immediately vested and exercisable through their remaining contractual term. In 2002, $48 million of pretax compensation expense related to this modification was recognized by AT&T Broadband and is included within gain on disposition of discontinued operations.

Under the AT&T 1996 Employee Stock Purchase Plan (ESPP), which was effective July 1, 1996, and amended on May 23, 2001, we are authorized to sell up to 21 million shares of AT&T common stock to our eligible employees through June 30, 2006. Under the terms of the ESPP, employees may have up to 10% of their earnings withheld to purchase AT&T's common stock. The purchase price of the stock on the date of exercise is 85% of the average high and low sale prices of shares on the New York Stock Exchange for that day. Under the ESPP, we sold approximately 1.3 million, 1.3 million and 1.2 million shares to employees in 2003, 2002 and 2001, respectively. Effective May 31, 2003, we suspended employee purchases of company stock under the ESPP.

Effective January 1, 2003, AT&T began recording compensation expense pursuant to SFAS No. 123 for all stock options issued subsequent to January 1, 2003. The fair value of all stock options issued subsequent to January 1, 2003 is measured on the grant date using the Black-Scholes option pricing model and recognized in the income statement over the vesting period (see note 1).

A summary of the AT&T common stock option transactions is as follows:

Shares in Thousands	2003	Weighted-Average Exercise Price[(1)]	2002	Weighted-Average Exercise Price[(1)]	2001	Weighted-Average Exercise Price[(1)]
Outstanding at January 1,	98,257	$40.64	63,509	$122.90	49,805	$179.10
Options granted	25,359	17.36	15,183	68.84	13,680	110.85
AT&T Wireless split-off adjustments	—		—		4,330	
AT&T Broadband spin-off adjustments	—		37,049		—	
Options and SARs exercised	(745)	12.60	(436)	32.28	(1,044)	58.15
Options canceled or forfeited	(4,411)	36.10	(17,048)	125.72	(3,262)	155.35
Options outstanding at December 31,	118,460	35.99	98,257	40.64	63,509	122.90
Options exercisable at December 31,	68,825	44.18	46,770	49.88	34,289	130.25
Shares available for grant at December 31,	19,487[(2)]		27,751		6,944	

(1) The weighted-average exercise prices for the period prior to the AT&T Wireless split-off in 2001 have not been adjusted to reflect the impact of the split-off. The weighted-average exercise prices for the period prior to the AT&T Broadband spin-off in 2002 and for the year ended December 31, 2001, have not been adjusted to reflect the impact of the spin-off.

(2) 2,090 shares are available for grants other than stock options.

The following table summarizes information about the AT&T common stock options outstanding at December 31, 2003:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at December 31, 2003	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable at December 31, 2003	Weighted-Average Exercise Price
	(In thousands)			(In thousands)	
$3.93 - $17.22	693	2.6	$10.21	693	$10.21
$17.32	23,455	9.4	$17.32	1,225	$17.32
$17.47 - $23.70	2,505	6.5	$20.39	1,505	$19.78
$23.88	10,249	8.7	$23.88	4,864	$23.88
$23.94 - $28.00	1,160	7.5	$25.75	738	$25.58
$28.03	21,087	8.1	$28.03	8,586	$28.03
$28.23 - $32.54	2,295	6.8	$30.38	1,961	$30.39
$32.63	5,493	7.5	$32.63	3,551	$32.63
$32.64 - $33.66	1,113	6.5	$33.45	889	$33.45
$33.68	8,118	7.2	$33.68	5,274	$33.68
$33.77 - $38.10	7,379	3.9	$35.74	6,846	$35.76
$38.31 - $46.73	7,581	3.4	$41.46	7,317	$41.32
$46.91	5,398	6.6	$46.91	4,451	$46.91
$47.04 - $61.45	3,395	5.0	$55.84	3,360	$55.88
$61.54	4,884	4.1	$61.54	4,884	$61.54
$61.66 - $87.01	8,710	5.9	$71.10	8,041	$71.34
$87.51 - $90.80	4,945	5.1	$87.52	4,640	$87.52
	118,460	7.0	$35.99	68,825	$44.18

A summary of the AT&T Wireless Group tracking stock option transactions is as follows:

	2001	Weighted-Average Exercise Price
	(Shares in thousands)	
Outstanding at January 1	73,626	$29.29
Options granted	4,037	$22.57
Options exercised	(1)	$22.03
Options canceled or forfeited	(2,711)	$29.11
Options assumed by AT&T Wireless on July 9	(74,951)	
Options outstanding at December 31	—	

In 2003 and 2001, AT&T granted 2.4 million and 0.7 million restricted stock units, respectively, to key employees. These awards generally vest after three years. In addition, in 2002, AT&T offered employees the option to cancel certain outstanding stock options and replace them with restricted stock units. Approximately 15 million stock options were canceled as a result of this offer, and 2.5 million restricted stock units were granted, which vest over a three-year period. The 2.5 million restricted stock units were restructured into 6.5 million units as a result of the spin-off of AT&T Broadband. Those options that were eligible for cancellation but retained by the employee became variable awards under APB Opinion No. 25, with compensation expense adjusted for current stock price until the options are exercised, forfeited, or expired unexercised. The cancellation of stock options had an immaterial impact on 2003 and 2002 results of operations.

In 2002 and 2001, AT&T granted performance share units to key employees. These awards are based on the attainment of certain performance measures over a three-year period. Approximately 0.9 million and 0.5 million units were granted in 2002 and 2001, respectively.

The weighted-average fair values at date of grant for AT&T common stock options granted during 2003, 2002 and 2001 were $5.49, $24.49 and $39.50, respectively, and were estimated using the Black-Scholes option-pricing model. The 2002 and 2001 weighted-average grant-date fair values exclude the effects of equity restructuring relating to the spin-off of AT&T Broadband and the split-off of AT&T Wireless. The weighted-average fair values at date of grant for AT&T Wireless Group tracking stock options granted during 2001 were $11.58 and were estimated using the Black-Scholes option-pricing model. The following weighted average assumptions were used for stock options granted during 2003, 2002 and 2001:

	AT&T Common Stock Options			AT&T Wireless Group Stock Options
	2003	2002	2001	2001
Risk-free interest rate	2.53%	3.73%	4.61%	4.92%
Expected dividend yield	4.00%	1.17%	0.85%	0.00%
Expected volatility	47.9%	40.0%	36.9%	55.0%
Expected life (in years)	5.0	4.7	4.7	4.8

13. Income Taxes

The following table shows the principal reasons for the difference between the effective income tax rate and the U.S. federal statutory income tax rate:

	For the Years Ended December 31,		
	2003	2002	2001
	(Dollars in millions)		
U.S. federal statutory income tax rate	35%	35%	35%
Federal income tax (provision) at statutory rate	$(942)	$ (993)	$(2,683)
Amortization of investment tax credits	16	16	18
State and local income tax (provision), net of federal income tax effect	(59)	(222)	(209)
AT&T Latin America	35	(360)	—
Foreign operations, net of tax credits	1	(140)	(107)
Investment dispositions, acquisitions and legal entity restructurings	51	93	91
Research and other credits	12	51	42
Research tax credit claims for prior years	143	—	—
Other differences, net	(73)	(32)	(42)
(Provision) for income taxes	$(816)	$(1,587)	$(2,890)
Effective income tax rate	30.3%	56.0%	37.7%

The U.S. and foreign components of income from continuing operations before income taxes and the (provision) for income taxes are presented in the following table:

	For the Years Ended December 31,		
	2003	2002	2001
	(Dollars in millions)		
Income (loss) from continuing operations before income taxes:			
United States	$ 2,761	$ 2,924	$ 7,671
Foreign	(71)	(88)	(5)
Total	$ 2,690	$ 2,836	$ 7,666
(Provision) benefit for income taxes:			
Current:			
Federal	$ 342	$ 1,041	$(1,554)
State and local	250	19	(192)
Foreign	(6)	(95)	(98)
	586	965	(1,844)
Deferred:			
Federal	(1,102)	(2,201)	(936)
State and local	(341)	(360)	(129)
Foreign	25	(7)	1
	(1,418)	(2,568)	(1,064)
Deferred investment tax credits	16	16	18
(Provision) for income taxes	$ (816)	$(1,587)	$(2,890)

We also recorded current and deferred income tax (provision) benefits that resulted from earnings (losses) related to other equity investments in the amounts of $(31) million in 2003, $112 million in 2002 and $2.9 billion in 2001.

Deferred income tax liabilities are taxes we expect to pay in future periods. Similarly, deferred income tax assets are recorded for expected reductions in taxes payable in future periods. Deferred income taxes arise because of differences in the book and tax basis of certain assets and liabilities.

Deferred income tax liabilities and assets consist of the following:

	At December 31, 2003	At December 31, 2002
	(Dollars in millions)	
Deferred Income Tax Assets:		
Reserves and allowances	$ 979	$1,237
Employee pensions and other benefits	335	604
Business restructuring	163	297
Investments	—	281
Net operating loss, capital loss and credit carryforwards	425	252
Advance payments	95	174
Other deferred tax assets	119	162
Valuation allowance	(857)	(689)
Total deferred income tax assets	1,259	2,318
Deferred Income Tax Liabilities:		
Property, plant and equipment	3,883	3,135
Leveraged and capital leases	937	1,059
Capitalized software and intangible assets	924	743
Investments	97	—
Other	98	298
Total deferred income tax liabilities	5,939	5,235
Net deferred income tax liability	$4,680	$2,917

In 2003, the valuation allowance increased $168 million, primarily attributable to an increase in net operating and capital loss carryforwards for state income tax purposes. In 2002, we established a valuation allowance for the book and tax basis difference relating to our investment in AT&T Latin America. During February 2004, the subsidiaries of AT&T Latin America were sold to Telefonos de Mexico S.A. de C.V., or Telmex, and the plan of bankruptcy liquidation of AT&T Latin America became effective. As a result, we will reevaluate the need for this valuation allowance and could record an income tax benefit of approximately $0.3 billion in the first quarter of 2004.

At December 31, 2003, we had net operating and capital loss carryforwards (tax effected) for federal, state and foreign income tax purposes of $5 million, $289 million, and $3 million, respectively, expiring through 2023. In addition, at December 31, 2003, we had state tax credit carryforwards (after federal tax effects) of $128 million expiring through 2017.

14. Commitments and Contingencies

In the normal course of business we are subject to proceedings, lawsuits and other claims, including proceedings under laws and regulations related to environmental and other matters. Such matters are subject to many uncertainties, and outcomes are not predictable with assurance. Consequently, we are unable to ascertain the ultimate aggregate amount of monetary liability or financial impact with respect to these matters at December 31, 2003. However, we believe that after final disposition, any monetary liability or financial impact to us beyond that provided for at December 31, 2003, would not be material to our annual consolidated financial statements.

We have been named as a defendant in a consolidated group of purported securities class action lawsuits filed in the United States District Courts for the District of New Jersey on behalf of persons who purchased shares of AT&T common stock from October 25, 1999 through May 1, 2000. These lawsuits allege, among other things, that during the period referenced above, we made materially false and misleading statements and omitted to state material facts concerning our future business prospects. The consolidated complaint seeks unspecified damages. Similar claims have been asserted by plaintiffs against us in two derivative actions, which were dismissed by the New Jersey federal court on January 7, 2004. We believe that the lawsuits are without merit and intend to defend them vigorously.

We have also been named as a defendant in another consolidated group of securities class actions filed in the United States District Court for the Southern District of New York, filed on behalf of investors who purchased shares in the AT&T Wireless tracking stock initial public offering (IPO) from April 26, 2000 through May 1, 2000. These lawsuits allege that we made materially false and misleading statements and omitted to state material facts in the IPO prospectus about AT&T's future business prospectus. The plaintiffs seek unspecified damages. We believe that the lawsuit is without merit and intend to defend it vigorously.

Recently, two participants in our Long Term Savings Plan for Management Employees (the Plan) filed purported class actions in New Jersey federal court on behalf of all Plan participants who purchased or held shares of AT&T Stock Fund, AT&T stock, AT&T Wireless Stock Fund or AT&T Wireless stock between September 30, 1999 and May 1, 2000. The complaint asserts claims similar to those made in the securities class action lawsuit described above, alleging that we made materially false and misleading statements and omitted to state material facts concerning our future business prospectus. As a result of this purported conduct, we are alleged to have breached our fiduciary duties to the Plan and the Plan's participants. The plaintiffs seek unspecified damages. We believe that the lawsuits are without merit and intend to defend them vigorously.

Through a former subsidiary, we owned approximately 23% of the outstanding common stock and 74% of the voting power of the outstanding common stock of At Home Corporation (At Home), which filed for bankruptcy protection on September 28, 2001. Until October 1, 2001, AT&T appointed a majority of At Home's directors and thereafter we appointed none. On November 7, 2002, the trustee for the bondholders' liquidating trust of At Home (the Bondholders) filed a lawsuit in California state court asserting claims for breach of fiduciary duty relating to the conduct of AT&T and its designees on the At Home board of directors in connection with At Home's declaration of bankruptcy and subsequent efforts to dispose of some of its businesses or assets, as well as in connection with other aspects of our relationship with At Home. On November 15, 2002, the Bondholders filed a lawsuit in California federal court asserting a claim for patent infringement relating to AT&T's broadband distribution and high-speed Internet backbone networks and equipment. The Bondholders seek unspecified damages in these lawsuits. We believe that these lawsuits are without merit and intend to defend them vigorously.

In addition, purported class action lawsuits have been filed in California state court on behalf of At Home shareholders against AT&T, At Home, and the directors of At Home, Cox and Comcast. The lawsuits claim that the defendants breached fiduciary obligations of care, candor and loyalty in connection with a transaction announced in March 2000 in which, among other things, AT&T, Cox and Comcast agreed to extend existing distribution agreements, the Board of Directors of At Home was reorganized, and we agreed to give Cox and Comcast rights to sell their At Home shares to us. These actions have been consolidated by the court and are subject to a stay. AT&T's liability for any such suits would be shared equally between AT&T and Comcast. In March 2002 and the summer of 2003 purported class actions were filed in the United States District Court for the Southern District of New York against, inter alia, AT&T and certain of its senior officers alleging violations of the federal securities law in connection with the disclosures made by At Home in the period from April 17 through August 28, 2001. The 2003 lawsuit adds At Home as a defendant. We believe that these lawsuits are without merit and intend to defend them vigorously.

The creditors of At Home recently filed a preference action against AT&T in the At Home bankruptcy proceeding pending in California federal court. The complaint alleges that we should be viewed as an insider of At Home. On this theory, At Home seeks to avoid one year's worth of payments to us as opposed to the non-insider ninety-day period prior to the filing of the bankruptcy petition. The plaintiffs seek damages of approximately $89.6 million from AT&T and Comcast. We believe that this action is without merit and intend to defend it vigorously.

Two putative class actions have been filed in Delaware state court on behalf of shareholders of AT&T Latin America (ATTLA). The complaints allege that AT&T and its designees to the ATTLA board of directors violated their fiduciary duties to ATTLA as a result of purported changes in our relationship with ATTLA, including our decision to discontinue funding to ATTLA and an alleged change in our plan to enter into a tax sharing agreement with ATTLA. The plaintiffs seek unspecified damages. We believe that these lawsuits are without merit and intend to defend them vigorously. In March 2004, the Delaware Chancery Court granted AT&T's motion to dismiss these claims. Plaintiffs may appeal the judgment.

Thirty putative class actions have been filed in various jurisdictions around the country challenging the manner in which we disclose Federal Communications Commission (FCC) imposed universal service fund charges to our customers and how we recoup those charges from our customers. The plaintiffs in each lawsuit seek unspecified damages. We believe that these lawsuits are without merit and intend to defend them vigorously.

More than thirty class actions have been brought against us throughout the country in which the plaintiffs have asserted superior property rights with respect to railroad right of way corridors on which we have installed fiber optic cable under agreements with the various railroads. Although we deny any liability, we have engaged in settlement negotiations concerning the so-called "active line" claims that have been consolidated and are pending in Indiana federal court. We have settled claims on a state-by-state basis and obtained final approval of such claims in Ohio, Connecticut, Wisconsin, Maryland and Virginia. In addition, in the second quarter of 2004, we anticipate that the parties will request preliminary approval of similar "active line" settlements in Delaware, Massachusetts, Michigan, West Virginia and Idaho. We also anticipate using these settlements as a template for settling "active line" claims in other states. However, these settlements do not involve "active line" claims along railroad right of way obtained under federal land grant statutes nor do they address claims that are based upon the installation of fiber optic cable in pipeline or other utility right of way.

In connection with the separation of our former subsidiaries, we have entered into a number of separation and distribution agreements that provide, among other things, for the allocation and/or sharing of certain costs associated with potential litigation liabilities. For example, pursuant to these agreements, AT&T shares in the cost of certain litigation (relating to matters while affiliated with AT&T) if the settlement exceeds certain thresholds. With the exception of two matters already reserved for (Sparks, et al. v. AT&T and Lucent Technologies and NCR's Fox River environmental clean-up matter, see note 2), we have assessed, as of December 31, 2003, that none of the litigation liabilities allocated to former subsidiaries were probable of incurring costs in excess of the threshold above which we would be required to share in the costs. However, in the event these former subsidiaries were unable to meet their obligations with respect to these liabilities due to financial difficulties, we could be held responsible for all or a portion of the costs, irrespective of the sharing agreements.

In October 2003, the FCC found that we violated Section 203 of the Communications Act of 1934 (Act) for refusing to transfer the customers of one reseller to the service plans of another reseller. The actions that gave rise to this finding were the subject of a lawsuit filed in March 1995 in the United States District Court for the District of New Jersey by Combined Companies, Inc, Winback & Conserve, One Stop Financial, 800 Discounts and Group Discounts, Inc. against us. We appealed this decision, as we believe our actions were consistent with our obligations under the Act. In addition, our liability in this matter is subject to the plaintiff proving it sustained damages and demonstrating the amount to which it claims to be entitled. Thus, the extent of liability cannot be estimated at this time. In the original lawsuit, plaintiff had sought an injunction requiring us to transfer customers from one reseller to another. Plaintiff has not filed an amended complaint asserting damages.

Leases and Other Commitments

From time to time, we provide guarantees of debt or other obligations relating to former subsidiaries. (Guarantees are occasionally provided for subsidiaries when owned by AT&T or in connection with its separation from AT&T. See note 9 for a detailed discussion of these guarantees.)

We lease land, buildings and equipment through contracts that expire in various years through 2051. Our rental expense, net of sublease rental income, under operating leases was $473 million in 2003, $529 million in 2002 and $552 million in 2001. The total of minimum rentals to be received in the future under non-cancelable operating subleases as of December 31, 2003, was $278 million. In addition, we have liabilities recorded on the balance sheet of approximately $0.2 billion relating to facilities that have been closed, under which we still have operating lease commitments. These commitments are included in the table below.

The following table shows our future minimum commitments due under non-cancelable operating and capital leases at December 31, 2003:

	Operating Leases	Capital Leases
	(Dollars in millions)	
2004	$ 400	$ 18
2005	341	11
2006	286	10
2007	230	9
2008	189	8
Later years	364	85
Total minimum lease payments	$1,810	$141
Less: Amount representing interest		45
Present value of net minimum lease payments		$ 96

We have contractual obligations to purchase certain goods or services from various other parties. Such unconditional purchase obligations totaled approximately $994 million as of December 31, 2003. Cash outflows associated with these obligations are expected to be approximately $350 million in 2004; $241 million in total for 2005 and 2006; $109 million in total for 2007 and 2008; and $294 million in total for years thereafter.

Under certain real estate operating leases we could be required to make payments to the lessors of up to $20 million at the end of the lease term in 2007.

15. Segment Reporting

AT&T's results are segmented according to the customers we service: AT&T Business Services and AT&T Consumer Services.

Our existing segments reflect certain managerial changes that were implemented during 2003. The changes primarily include a redistribution of property, plant and equipment from the Corporate and Other group to AT&T Business Services and a transfer of deferred taxes from AT&T Consumer Services to the Corporate and Other group.

AT&T Business Services provides a variety of communication services to various sized businesses and government agencies including long distance, international, toll-free and local voice, including wholesale transport services, as well as data services and Internet protocol and enhanced (IP&E) services, which includes the management of network servers and applications. AT&T Business Services also provides outsourcing solutions and other professional services.

AT&T Consumer Services provides a variety of communication services to residential customers. These services include traditional long distance voice services, such as domestic and international dial services (long distance or local toll calls where the number "1" is dialed before the call) and calling card services. Transaction services, such as prepaid card and operator-assisted calls, are also offered. Collectively, these services represent stand-alone long distance and are not offered in conjunction with any other service. AT&T Consumer Services also provides dial-up Internet services and all distance services, which bundle long distance, local and local toll.

The balance of AT&T's continuing operations (excluding LMG) is included in a "Corporate and Other" group. This group primarily reflects corporate staff functions and the elimination of transactions between segments.

LMG was not an operating segment of AT&T prior to its split-off from AT&T because AT&T did not have a controlling financial interest in LMG for financial accounting purposes. Therefore, we accounted for this investment under the equity method. Additionally, LMG's results were not reviewed by the chief operating decision-makers for purposes of determining resources to be allocated.

Total assets for our reportable segments include all assets, except intercompany receivables. Nearly all prepaid pension assets, taxes and corporate-owned or leased real estate are held at the corporate level and therefore are included in the Corporate and Other group. Capital additions for each segment include capital expenditures for property, plant and equipment, additions to nonconsolidated investments, and additions to internal-use software (which are included in other assets).

The accounting policies of the segments are the same as those described in the summary of significant accounting policies (see note 1). AT&T evaluates performance based on several factors, of which the primary financial measure is operating income.

Generally, AT&T accounts for inter-segment transactions at market prices. AT&T Business Services sells services to AT&T Consumer Services at cost-based prices, which approximate average market prices. These sales are recorded by AT&T Business Services as contra-expense.

Revenue

	For the Years Ended December 31,		
	2003	2002	2001
	(Dollars in millions)		
AT&T Business Services revenue			
Long distance voice	$11,116	$12,254	$13,930
Local voice	1,484	1,155	1,020
Total voice	12,600	13,409	14,950
Data services	7,882	8,260	8,128
IP&E services	1,840	1,677	1,349
Total data services and IP&E services	9,722	9,937	9,477
Outsourcing, professional services and other	2,670	3,212	3,278
Total AT&T Business Services revenue(1)	24,992	26,558	27,705
AT&T Consumer Services revenue			
Stand-alone long distance, transactional and other services	7,485	10,413	13,973
Bundled services	1,999	1,114	870
Total AT&T Consumer Services revenue	9,484	11,527	14,843
Total reportable segments	34,476	38,085	42,548
Corporate and Other	53	(258)	(351)
Total revenue	$34,529	$37,827	$42,197

(1) Revenue in 2002 and 2001 included internal revenue of $323 million and $441 million, respectively, which represented sales to AT&T Broadband and AT&T Wireless through their dates of disposition. AT&T Broadband and AT&T Wireless were disposed of on November 18, 2002 and July 9, 2001, respectively. Subsequent to their disposition, sales to AT&T Broadband, now Comcast, and AT&T Wireless are recorded as external revenue.

Depreciation and Amortization

	For the Years Ended December 31,		
	2003	2002	2001
	(Dollars in millions)		
AT&T Business Services	$4,620	$4,546	$4,234
AT&T Consumer Services	142	230	200
Total reportable segments	4,762	4,776	4,434
Corporate and Other	108	112	125
Total depreciation and amortization	$4,870	$4,888	$4,559

Net (Losses) Related to Other Equity Investments

	For the Years Ended December 31,		
	2003	2002	2001
	(Dollars in millions)		
AT&T Business Services pretax net earnings (losses)	$ 32	$(454)	$(6,482)
Corporate and Other pretax net (losses)	(13)	(58)	(1,301)
Total pretax earnings (losses)	19	(512)	(7,783)
Total tax (provision) benefit	(31)	112	2,947
Total net (losses) related to other equity investments	$(12)	$(400)	$(4,836)

Reconciliation of Operating Income to Income from Continuing Operations Before Income Taxes, Minority Interest Income and Net (Losses) Related to Equity Investments

	For the Years Ended December 31,		
	2003	2002	2001
	(Dollars in millions)		
AT&T Business Services operating income	$ 1,888	$ 1,965	$ 3,573
AT&T Consumer Services operating income	2,062	2,592	4,698
Total reportable segments operating income	3,950	4,557	8,271
Corporate and Other operating (loss)	(293)	(196)	(439)
Operating income	3,657	4,361	7,832
Other income (expense), net	191	(77)	1,327
Interest (expense)	(1,158)	(1,448)	(1,493)
Income from continuing operations before income taxes, minority interest income and net (losses) related to other equity investments	$ 2,690	$ 2,836	$ 7,666

Assets

	At December 31,	
	2003	2002
	(Dollars in millions)	
AT&T Business Services	$34,202	$36,389
AT&T Consumer Services	1,062	1,390
Total reportable segments	35,264	37,779
Corporate and Other assets[1]	12,724	17,658
Total assets	$47,988	$55,437

[1] Includes cash of $4.0 billion for 2003 and $7.8 billion for 2002.

Capital Additions

	For the Years Ended December 31,		
	2003	2002	2001
	(Dollars in millions)		
AT&T Business Services	$3,185	$3,716	$5,451
AT&T Consumer Services	74	127	140
Total reportable segments	3,259	3,843	5,591
Corporate and Other	223	63	150
Total capital additions	$3,482	$3,906	$5,741

Geographic Information

Revenue(1)

	For the Years Ended December 31,		
	2003	2002	2001
	(Dollars in millions)		
United States(2)	$32,952	$36,202	$40,512
International	1,577	1,625	1,685
Total revenue	$34,529	$37,827	$42,197

Long-Lived Assets(3)

	At December 31,	
	2003	2002
	(Dollars in millions)	
United States(2)	$27,758	$29,097
International	1,918	1,689
Total long-lived assets	$29,676	$30,786

(1) Revenue is reported in the geographic area in which it originates.

(2) Includes amounts attributable to operations in Puerto Rico and the Virgin Islands.

(3) Long-lived assets include property, plant and equipment, net, goodwill and other purchased intangibles, net.

Based on a review of our management model, we plan to transfer our remaining payphone business from the AT&T Consumer Services segment to the AT&T Business Services segment, which will require the restatement of our segments in 2004. Additionally, we will continue to review our management model and structure, which may result in additional adjustments to our operating segments in the future.

16. Related Party Transactions

AT&T had various related party transactions with Concert until the joint venture was officially unwound on April 1, 2002.

Included in revenue was $268 million and $1.1 billion for services provided to Concert for the years ended December 31, 2002 and 2001, respectively.

Included in access and other connection expenses are charges from Concert representing costs incurred on our behalf to connect calls made to foreign countries (international settlements) and costs paid by AT&T

to Concert for distributing Concert products totaling $491 million and $2.1 billion for the years ended December 31, 2002 and 2001, respectively.

We had various related party transactions with LMG. Included in costs of services and products were programming expenses related to services from LMG. These expenses amounted to $199 million for the seven months ended July 31, 2001, the effective split-off date of LMG for accounting purposes.

17. Quarterly Information (Unaudited)

2003

	First	Second	Third	Fourth
	(Dollars in millions, except per share amounts)			
Revenue	$ 8,986	$ 8,795	$ 8,649	$ 8,099
Operating income	1,166	1,029	829	633
Income from continuing operations	529	536	458	340
Net (loss) from discontinued operations (net of income taxes)	—	—	(13)	—
Income before cumulative effect of accounting change	529	536	445	340
Cumulative effect of accounting change (net of income taxes)	42	—	(27)	—
Net income	571	536	418	340
AT&T Common Stock Group:				
Earnings (loss) per share — basic[1]:				
Earnings from continuing operations	$ 0.67	$ 0.68	$ 0.58	$ 0.43
(Loss) from discontinued operations	—	—	(0.02)	—
Cumulative effect of accounting change	0.06	—	(0.03)	—
AT&T Common Stock Group earnings	$ 0.73	$ 0.68	$ 0.53	$ 0.43
Earnings (loss) per share — diluted[1]:				
Earnings from continuing operations	$ 0.67	$ 0.68	$ 0.58	$ 0.43
(Loss) from discontinued operations	—	—	(0.02)	—
Cumulative effect of accounting change	0.06	—	(0.03)	—
AT&T Common Stock Group earnings	$ 0.73	$ 0.68	$ 0.53	$ 0.43
Dividends declared	$0.1875	$0.1875	$0.2375	$0.2375
AT&T common stock prices[2]				
High	$ 27.89	$ 21.84	$ 23.18	$ 21.95
Low	15.75	13.45	18.80	18.31
Quarter-end close	16.20	19.25	21.55	20.30

2002

	First	Second[3]	Third	Fourth[4]
	(Dollars in millions, except per share amounts)			
Revenue	$ 9,548	$ 9,580	$ 9,409	$ 9,290
Operating income (loss)	1,634	1,592	1,415	(280)
Income (loss) from continuing operations	446	603	525	(611)
Net (loss) from discontinued operations (net of income taxes)	(565)	(13,433)	(318)	(197)
Gain on disposition of discontinued operations (net of income taxes)	—	—	—	1,324
(Loss) income before cumulative effect of accounting change	(119)	(12,830)	207	516
Cumulative effect of accounting change (net of income taxes)	(856)	—	—	—
Net (loss) income	(975)	(12,830)	207	516
AT&T Common Stock Group:				
Earnings (loss) per share — basic[1]:				
Earnings (loss) from continuing operations	$ 0.63	$ 0.83	$ 0.68	$ (0.79)
(Loss) from discontinued operations	(0.80)	(18.41)	(0.41)	(0.26)
Gain on disposition of discontinued operations	—	—	—	1.71
Cumulative effect of accounting change	(1.21)	—	—	—
AT&T Common Stock Group (loss) earnings	$ (1.38)	$ (17.58)	$ 0.27	$ 0.66
Earnings (loss) per share — diluted[1]:				
Earnings (loss) from continuing operations	$ 0.60	$ 0.80	$ 0.67	$ (0.79)
(Loss) from discontinued operations	(0.76)	(17.91)	(0.41)	(0.26)
Gain on disposition of discontinued operations	—	—	—	1.71
Cumulative effect of accounting change	(1.16)	—	—	—
AT&T Common Stock Group (loss) earnings	$ (1.32)	$ (17.11)	$ 0.26	$ 0.66
Dividends declared	$0.1875	$ 0.1875	$0.1875	$0.1875
AT&T common stock prices[2]				
High	$ 39.47	$ 32.50	$ 26.35	$ 29.42
Low	27.62	18.64	16.81	21.43
Quarter-end close	32.19	21.94	24.62	26.11

(1) Earnings per share (EPS) in each quarter is computed using the weighted-average number of shares outstanding during the quarter while EPS for the full year is computed using the weighted-average number of shares outstanding during the year. Thus, the sum of the four quarters' EPS does not always equal the full-year EPS.

(2) Stock prices obtained from the New York Stock Exchange Composite Tape.

(3) The loss from discontinued operations in the second quarter of 2002 included $16.5 billion ($11.8 billion after taxes) of goodwill and franchise costs impairment charges.

(4) Fourth quarter 2002 net income included $1.5 billion of net restructuring and other charges.

In September 2003, in conjunction with our review of accounting and internal control systems, we determined that the liability on the balance sheet (included in accounts payable and accrued expenses) relating to costs incurred in 2001 and 2002 pertaining to access and other connection expenses was understated by $125 million. Since the impact to prior years' annual financial statements was not material, we recorded an additional expense of $125 million ($77 million after taxes) in the third quarter of 2003 to reflect the proper estimate of the liability.

A review was conducted by outside legal counsel, under the direction of the Audit Committee. This review found that two employees, one lower-level and one mid-level management employee, circumvented the internal controls process, resulting in the financial impacts noted below. We made the appropriate personnel changes and enhanced our internal controls accordingly. The principal focus of these enhancements included higher skill levels of those performing the function (mid-level manager must be a Certified Public Accountant), changes in the approval process for accruing access expense, as well as additional reviews of such expenses and related reconciliations by higher levels of management (Business Unit Controller and AT&T Controller). In addition, actual access payments are reviewed quarterly to further substantiate the recorded liability.

The expense, properly recorded in the respective periods, would have impacted quarterly and annual income from continuing operations as follows:

	Income from Continuing Operations	Earnings Per Diluted Share — Continuing Operations
	Impact: (Decrease)/Increase (Dollars in millions, except per share amounts)	
For the Three Months Ended:		
September 30, 2001	$(33)	$(0.04)
December 31, 2001	$ 1	$ 0.01
March 31, 2002	$(64)	$(0.08)
June 30, 2002	$ 12	$ 0.02
September 30, 2002	$ 14	$ 0.01
December 31, 2002	$ (7)	$(0.01)
For the Year Ended:		
December 31, 2001	$(32)	$(0.04)
December 31, 2002	$(45)	$(0.06)

18. Subsequent Events

In February 2004, we offered to repurchase, for cash, any and all of our $1.5 billion outstanding 6.5% Notes maturing in November 2006, which now carry an interest rate of 7.25%. The offer to early redeem these securities expired on March 3, 2004, with $1.2 billion of notes redeemed, which will result in a loss of approximately $150 million in the first quarter of 2004. In connection with the debt redemption, we unwound $250 million notional amount of fixed-to-floating interest rate swaps. Also, we offered to repurchase for cash up to €1 billion of our outstanding €2 billion 6.0% Notes due November 2006, which now carry an interest rate of 6.75%. This repurchase is expected to close by the end of March 2004.

In March 2004, a U.S. Court of Appeals vacated a number of recent FCC rulings made in connection with the Triennial Review, including the FCC's delegation to state commissions of decisions over impairment as applied to mass market switching and certain transport elements. If this decision is not reversed, or unless the FCC issues new valid rules, which assure us of fair resale prices, our current local business could be materially affected.